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CIS

EFFECTS OF HIGH INTEREST RATES ON MARYLAND COMMUNITIES

HEARINGS

BEFORE THE

SUBCOMMITTEE ON
INVESTMENT, JOBS, AND PRICES

OF THE

JOINT ECONOMIC COMMITTEE
CONGRESS OF THE UNITED STATES

NINETY-SEVENTH CONGRESS

FIRST SESSION

AUGUST 31, SEPTEMBER 1, 2, 3, AND 4, 1981

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EFFECTS OF HIGH INTEREST RATES ON MARYLAND COMMUNITIES

MONDAY, AUGUST 31, 1981

CONGRESS OF THE UNITED STATES,
SUBCOMMITTEE ON INVESTMENT, JOBS, AND PRICES
OF THE JOINT ECONOMIC COMMITTEE,
Washington, D.C.

The subcommittee met, pursuant to notice, at 2:15 p.m., in room 106, Baltimore County Office Building, Towson, Md., Hon. Paul S. Sarbanes (member of the subcommittee) presiding.

Present: Senator Sarbanes.

Also present: James K. Galbraith, executive director; William R. Buechner, professional staff member; and Betty Maddox, assistant director for administration.

OPENING STATEMENT OF SENATOR SARBANES, PRESIDING

Senator SARBANES. Today the Subcommittee on Investment, Jobs, and Prices of the Joint Economic Committee begins a series of hearings across the State of Maryland to review and document the effects of high interest rates on Maryland citizens and communities.

In 6 separate hearings this week, the subcommittee will hear from more than 80 witnesses about the severe challenge of high interest rates—a challenge which these witnesses know best since they face it daily in their own economic activities.

It is no exaggeration to say that the problems created by continuing high interest rates are approaching crisis proportions.

The situation this year, with the prime rate remaining over 17.5 percent, is unparalleled. In the last 12 months, the prime has been as high as 21.5 percent; today, it remains at 20.5 percent.

The mortgage rate at many financial institutions is over 17 percent, the highest it has ever been. The interest rate on tax-free municipal bonds is now over 11 percent, twice what local governments had to pay only 4 years ago.

These rates have created great obstacles to the operations of many established and productive enterprises, particularly in those sectors of the economy which depend upon a line of credit. The damage thus far is serious; and, if conditions are not soon improved, will be irreparable. Enterprises which have been an important asset to their respective communities, an important economic resource, will be lost.

The burden of high interest rates has become a major financial problem for small businesses. Auto dealers and other sellers of consumer durables have been particularly hit.

For the first time in the history of a quarterly survey by the National Federation of Independent Business, small businesses rank interest rates and financing as the single most important problem facing them. The survey, which was released last week, says:

"The currently high rates of interest are making a bad situation unbearable for many small firms."

Last year almost 12,000 businesses failed nationwide, the highest figure in more than a decade and almost double the number of failures in 1978, when interest rates were only half their current level.

The situation is particularly critical in the homebuilding industry. Housing starts last month stood at an annual adjusted rate of just over 1 million, down 17 percent from the already-reduced pace of a year ago and only half the 2 million starts needed to meet nationwide demand.

Construction-related business is similarly depressed. Unemployment in the construction industry is running at 15 percent, more than twice the industrial average. Home sales have fallen dramatically, down in Maryland as much as one-third from the levels of 2 years ago.

With mortgage rates now around 17 percent, purchase of a median-priced house in the national capital area, for example, would require an annual income of more than $50,000—an income well above the national mean.

Financial institutions, particularly savings and loan associations, which have done so much to make homeownership a reality, face unprecedented pressure. High interest rates also have very serious implications for the finances of State and local governments.

As a Sunday's New York Times article commented—

> These are dark days for State and local treasuries. * * * Prices of municipal bonds have been sliding all year and fell to a historic low last week. At the same time, the interest rates that government have to pay on their new bonds have reached historic highs.

This is an especially serious blow at a time when State and local jurisdictions must look forward to sharp reductions in financial support from the Federal Government.

The Federal Reserve Bank in Richmond reports that Maryland farmers are now paying the highest interest rate they have ever had to pay for bank loans, with many farmers paying 2 percentage points above the current prime rate.

As a result, farmers across the State, as elsewhere in the Nation, have been postponing or abandoning productive investments which would make them more efficient and effective producers.

The purpose of these hearings is to document across the State, with testimony from those directly affected, the conditions to which these statistics attest.

Over the past 18 months, the Joint Economic Committee, created by the Employment Act of 1946 to provide Congress with economic information and advice, has held a number of hearings on the interest rate question, and will undoubtedly return to this matter when the committee, in the fall, begins its examination of the impact of the recently enacted economic program.

It is my hope and expectation that the record of the Maryland experience established by these hearings will make an important contribution to the committee's work and to the response which policymakers must undertake to remedy this pressing economic situation.

I want to thank those who have agreed to join us as witnesses today.

I think there is a witness list available. We have arranged it, to some extent, according to economic sectors of activity. And where there is more than one witness, we will hear people within that sector in panels.

Jim Lucass, who will be testifying for the County Executive, will be here later. He, of course, is the Director of Economic Development Commission.

We will therefore go first to the representatives of the financial institutions.

We are very pleased to have Thomas Devlin, who is the manager of the Baltimore County Employees Federal Credit Union, with us; and Mr. Thomas Marvel, who is the senior vice president of Loyola Federal Savings & Loan.

Gentlemen, if you would come forward, we would be very happy to receive your testimony.

Mr. Devlin, I think we will go alphabetically, and begin with you—unless you gentlemen have worked out some other order between yourselves.

If you will identify yourselves for the reporter, we would appreciate that.

STATEMENT OF THOMAS DEVLIN, MANAGER, BALTIMORE COUNTY EMPLOYEES FEDERAL CREDIT UNION, TOWSON, MD.

Mr. DEVLIN. I'm Thomas H. Devlin, manager for the Baltimore County Employees Federal Credit Union. My statement is very short.

High interest rates have had an effect on credit unions in this area, particularly those of us who have had to go to money market certificates and share certificates to prevent an outflow of cash to our competitors, banks and savings and loans, or building and loans. And now we are suffering, due to the high interest we must pay on these certificates. This, in turn, has caused us to increase our rates on our loans.

And, of course, this defeats one of the main purposes of credit unions, which is to serve the small saver. High interest rates, of course, increases the consumer's prices. Thus, a member, in an effort to take care of his family, will forego loan payments and savings; and this has caused a drastic increase on our bankruptcies and delinquencies in the credit union field.

Many members will also withdraw their savings, rather than pay the high interest rates. Here again, they drain the cash from the credit union, and not leaving us anything to loan out to our members.

It also dictates that we must be more careful and screen our loan applicants more carefully. Again, this hurts those who probably most desparately are in need of a loan.

Generally, this is how the overall high interest rates are affecting us. In fact, we're having another meeting tomorrow to determine whether we should raise our rates again on our loans just to cover these interest rates.

Tha't all I have to say.

Senator **Sarbanes**. Thank you.

Mr. Marvel.

STATEMENT OF THOMAS A. MARVEL, SENIOR VICE PRESIDENT, LOYOLA FEDERAL SAVINGS & LOAN ASSOCIATION, BALTIMORE, MD.

Mr. **Marvel**. Thank you, Mr. Chairman.

My name is Thomas A. Marvel. I'm senior vice president with Loyola Federal Savings & Loan Association and chief lending officer.

I would like to address my comments today to high interest rates and their impact on the thrift industry and relate that somewhat to the local economy.

I think it is kind of instructive to take a look at some of the changes that have affected our industry over the last couple of years.

As you all know, we have been fixed-rate, long-term, residential lenders for many, many years. That has been our sole purpose.

We have been, for a number of years, borrowing short and lending long, if you will. That has worked out pretty well for us when we had moderate inflation; but we have added some regulation on our savings rates that we paid our savers, but that is kind of out the window now.

A couple of years ago, we entered into a phase of deregulation. And the first thing that was attacked was our savings account, our savings portfolio, which we referred to as the liability side of our balance sheet. And we are now paying—I would say that 60 percent of our savings base is reflective of market rates; and probably 100 percent will be over the next 3 or 4 years, as the DIDC makes its final actions.

Just to give you an idea of how the rates have moved on us, in 1980, our money market certificate rate, which represents about 40 to 45 percent of our total savings base now—in 1980, it moved from 7¾ percent to 15.70 percent in just a period of 6 to 9 months, which is a lot if you think about the impact that it has on us.

The other side of our balance sheet is that the asset side—and that is made up of fixed-rate, long-term, residential loans—that rate—that the yield on that, the asset side of our balance sheet, has not moved anywhere near that. It moves maybe 5 or 10 basis points a year. So, what that has done, it has put us in a negative spread. It means we are losing money.

I would say that maybe 60 to 70 percent of the S. & L.'s in this State, as well as in the country, are losing money right now. It is as simple as that. There is no way we can do anything else but.

The other problem that we have, of course, is that we are seeing our money flow out, our savings base eroded because of the money market funds. We are losing substantial deposits. Over the last 7 months, we have lost a lot of dollars. And the growth of the money market funds really parallels the erosion of our savings base. We don't see any improvement in the situation at all in the near future.

I think the money market funds are the product of high inflation and high interest rates and the negative yield curve. The bottom line of all of this is that 60 to 75 percent of the residential mortgage lenders are out of the market; they don't have money to lend because they are losing savings dollars.

And as I said, the prospects for 1982 are not very good. We are witnessing a consolidation in the thrift industry and in the banking industry. We have seen mergers; we are going to see more mergers—it is inevitable.

I think that the building industry, the real estate industry are virtually at a standstill. We used to be an active construction lender. We used to have a number of builders come in for project loans. I have yet to have the first builder walk through my office door this year; they can't do it. Their projects will not support 20 percent interest rates; they just not will do it.

And again, the prospects are not good.

We have had a recent proposal for the All-Savers Certificate, which is held to be the panacea for our industry. Wrong, Not so. I don't perceive that to be the panacea. I think that, in the short run, it will help us, because it will reduce our cost of money. But there is no way that I can take the money and make long-term residential real estate loans with it because of the short-term nature of that certificate.

If they take that away from me in 15 months and all that moneys disintermediates again, I have got a terrible liquidity problem. So, I don't see that as being a panacea. I see it as being a help to reduce the cost of money and stop the outflows.

I really have no other comments. I would be happy to answer any questions.

And thank you, again, for the opportunity to testify.

Senator SARBANES. Gentlemen, thank you very much.

Mr. Marvel, let me ask you this question. You say that 60 to 70 percent of the S. & L.'s in this area are not making loans?

Mr. MARVEL. Yes, sir.

Senator SARBANES. And the ones that are making them, at what rates are they making them?

Mr. MARVEL. We are at 18 percent, and I think that is pretty much the market. And quite frankly, if I had a substantial volume of loan requests at 18 percent, I would move the rate, because I just don't have the dollars to make the loans.

Senator SARBANES. So you would move it upward?

Mr. MARVEL. I would move it up; that's right.

Senator SARBANES. Have late payments on mortgages gone up significantly over this period—and foreclosures?

Mr. MARVEL. No, they haven't. Our delinquency has held pretty constant. We have seen bankruptcies go up because of the favorable bankruptcy laws, but the late payments and foreclosures have remained pretty constant. And we could be bucking a trend. I understand that, nationwide, they have moved up a little bit.

Senator SARBANES. Now, Mr. Devlin, what is the situation with the credit unions in terms of making credit available to your customers?

Mr. **DEVLIN**. We are still issuing loans. And as I said, we are talking tomorrow—having a meeting tomorrow on our loan rates. Right now we're charging 15 percent on a personal loan. We are paying over 15 on our money market and 17 on the 30-month certificates. So, you can't keep doing business that way.

We are going to have to raise our loan rates to help cover the certificates.

Senator **SARBANES**. How would you characterize the current health of the credit union industry?

Mr. **DEVLIN**. That is a hard question to answer. It depends upon what industry your credit union is located in. We are very favorable, I think, because we are located in a governmental agency. In other words, we are not having layoffs, like the steel industry and the automobile industry. They are really hurting—those credit unions. But ours, in the governmental credit union—credit unions—I think, are holding their own. But we're still having a problem of having to pay those high rates and covering those high rates.

If we don't offer the money markets or the savers' certificates, then we don't get the money. They will take their money out and go down the street— you see, we're surrounded in Towson, here, by every bank and savings and loan in the State of Maryland. So, we are in competition with them.

At one time, everybody said the credit union was just a little old family affair. Not any more.

Senator **SARBANES**. Could you both address the deposit flows into and out of the S. & L.'s and the credit unions over the last few years? What has happended there? I think we ought to get that on the record.

Mr. **MARVEL**. OK.

Well, since the first of this year, we have seen substantial deposit outflows. And that has been pretty much throughout the industry within the State, and nationwide as well, And, of course, most of this money—or a great deal of the money has gone to the unregulated money market funds.

We are having a great deal of difficulty competing with these funds, because they are paying higher rates than we can pay; and, of course, because of the nature of the liquidity—it is an in-and-out situation—they can withdraw their money at any time. So, I would say that is where the bulk of the money has gone.

Previous, or prior to that, we had positive inflows, in 1980 and 1979, if my recollection serves me. I'm not sure of the exact amount, but we did have positive inflows until we got into a period of high interest rates and high inflation.

Senator **SARBANES**. What is your expectation for the future if these rates continue at these high levels?

Everyone is always promising that they will go down; and, obviously, that is a very deep concern on the part of many of us.

But, just to sketch out a scenario, what is your expectation of how things will go if the rates continue at these high levels for a substantial period of time?

Mr. **MARVEL**. Well, I don't think that they can continue at these high levels for 2 or 3 years. if they do, then I think we face the prospects of a very severe depression. Businesses can pay 20 and 25 percent for 6 or 8 months, but I don't think they can pay that kind of rate for 2 or 3 years; it is inconceivable to me.

Mr. **Devlin**. Well, I guess we have been lucky, because we have a stable membership, the Baltimore County employees and their immediate families. But we do lose the money market funds. We can't compete with them. We don't try to compete. We just wish the member good luck when he takes his umpteen thousand out.

And, as I say, we try. We haven't had a bit withdrawal. We have had a big drain on loans lately. And there, again, I guess the poor soul is trying to keep up with his bills.

Senator **Sarbanes**. Well, would you say your members are staying with you out of——

Mr. **Devlin**. Loyalty. Absolutely.

Senator **Sarbanes**. And do you expect that to continue, or are you concerned that if the pressures stay as they are——

Mr. **Devlin**. We have a certain group of investors, as any institution does. In other words, if we don't offer the best rate, they're going to take it and go down the street. And we try to compete the best way we can. But as i say, we're not going to try to compete with the money market funds; it is impossible.

Senator **Sarbanes**. Mr. Marvel, what was the figure you used for the Nation's S. & L.'s that you said were currently losing money?

Mr. **Marvel**. I would estimate that probably 60 percent of the Nation's S. & L.'s are in a negative-spread posture at this point.

Senator **Sarbanes**. And would you say that is true of the S. & L.'s here?

Mr. **Marvel**. Yes, that is true of the S. & L.'s here, as well.

Senator **Sarbanes**. Looking back over the last few years, what has happended to the composition of your deposits in terms of percentages?

Mr. **Marvel**. Well, over the past few years, of course, a substantial amount of our deposit base was held in the passbook account. And of course, as the certificate came on the scene, some of that passbook money moved into the certificate accounts. And as the money market certificate account came on the scene, the a majority of the deposit base moved into that account.

I would say we, in our association, probably have 40 percent of our desposit base in the money market certificate. That is the 6-mongh certificate. We also have a small percentage of our deposit base in jumbo certificates, or those are certificates that are $100,000 and above. We probably have 1 to 2 percent in jumbo—and I guess the national average is probably 10 to 15 percent—simply because we have not been aggressive for that type of certificate. We didn't need the liqudity. We didn't want to pay the high interest rates.

But most of our deposit base has moved to shorter term, market-sensitive instruments. That is the problem, not that the problem is deregulation—I'm not opposed to that. I think, in retrospect, we made the mistake—we deregulated the liability side of our balance sheet, and we should have started with the asset side, maybe 4 or 5 years, to give us time to position that, then deregulate the other side. It would have worked then, I think.

Senator **Sarbanes**. Is the composition of your asset base changing as well?

Mr. **Marvel**. No, unfortunately not, because we are not making loans. We don't have the money to make loans. It is changing, but not at the rate which we hoped it would change. Our portfolio ordinarily would roll over every 8 to 10 years; it would completely turn over. But that is, our course, when we were active lenders.

In our very active years, we were making $200 to $260 million in loans. This year, we will be very lucky to close $75 million in loans. So, you can see the decline in lending.

Senator **Sarbanes**. What kind of reaction are you getting from consumers—well, first of all, are they coming to you? And, second of all, if they are, what kind of reaction are you getting?

Mr. **Marvel**. At this point, they're not coming to us. Because of all of the publicity and the high interest rates, they realize that it is very difficult to qualify for an 18 percent loan.

And quite frankly, unless you really have to have a house or a mortgage, you're not going to look for an 18 percent loan, you're going to sit back and wait for better times, hopefully. So, they have really stopped coming at this point.

That's not to say the demand is not there, because we were active in the Baltimore City residential bond program, and we had some $45 million to lend. And that was all committed and loaned within a matter of 2 or 3 weeks. Those were rates of around 11 to 12 percent. So the demand is there—there's no question about it—but not at 18 percent.

Senator **Sarbanes**. Is there a significant difference in the rate, depending upon the down payment? I saw some figures that indicated there was no difference.

Mr. **Marvel**. No, there is no significant difference.

Senator **Sarbanes**. So, whether you put 5 percent down or 20 percent down, you're still paying about the same?

Mr. **Marvel**. You're still paying about the same rate; that's correct.

Senator **Sarbanes**. What, for an average-priced home, would the monthly payment be?

Mr. **Marvel**. I would say that you are probably close to—with the tax and insurance payments, you are probably close to $700 or $800 a month.

Senator **Sarbanes**. What kind of income would you expect a borrower to have to carry that monthly payment?

Mr. **Marvel**. I would think that you would need probably $30,000 to $35,000 a year.

Senator **Sarbanes**. Well, gentlemen, this has been very helpful.

We're going to hear from the homebuilders next, which, of course, ties right in with the problems you face.

I must say, to the S. & L.'s, as a member of the Senate Banking Committee, I have been quite concerned about your financial situation. The S. & L.'s have performed an enormously important function over the years in encouraging home ownership in this country. I think that it has been a very productive contribution.

And it is a matter of extreme concern that organizations which have operated extremely effectively are now facing grave obstacles to continuing operations. I don't think there is any valid charge of mismanagement or bad practices. We are talking about some of the most viable and effective of the institutions confronting external pressures that create a situation which has placed them in a situation of some jeopardy.

I think it is important to try to get these things back in balance so at least they can go on doing their business in a productive way.

Thank you very much, gentlemen, for your testimony.

We will now go on to David Thaler of the Omega Land Development Co. and George Schnader of the George L. Schnader Builders, Inc.

STATEMENT OF DAVID S. THALER, OMEGA LAND DEVELOPMENT CORP., BALTIMORE, MD., AND VICE PRESIDENT, BALTIMORE COUNTY CHAPTER, HOME BUILDERS ASSOCIATION OF MARYLAND

Mr. **Thaler**. Senator Sarbanes, ladies and gentlemen, my name is David Thaler. For the record, my offices are at 11 Warren Road, Baltimore, Md.

This afternoon, I represent the Home Builders Association of Maryland. The Home Builders Association represents approximately 1,000 member firms, who conduct business in the Baltimore metropolitan region. In normal times, our firms employ approximately 40,000 individuals.

By way of personal introduction, I am a consultant civil engineer, a builder, and a land developer. My family firm has been in the home building business in Baltimore City and Baltimore County for over 35 years. I am here today to express my serious concerns on behalf of our membership, about the tight money and high interest rate policy presently enforced by the Federal Reserve Board.

It is a great privilege, Senator Sarbanes, to testify here. But the thought occurred to me to be a little bit theatric, and I thought that I would go over to the sheriff's department and borrow one of his foreclosure notices, and tack it up on the wall. But the situation simply defies drama and defies rhetoric. Simply speaking, we are an industry that is literally haunted by the spectre of bankruptcy. We are having difficulty in meeting our obligations and making our payrolls.

The cause is simply the unprecedented continued high level of interest rates and its effect, of course, upon housing sales. Here in Baltimore County, the home building industry has suffered as deeply as any place in the country. Our production is off 65 percent from normal levels. The July building permit figures show that we took out just over 1,000 building permits during 1981; during a similar period in 1978, the building industry in Baltimore County had used almost 3,000 building permits.

There are virtually no multiple-family units begun in Baltimore County in 1981. With the continued conversion of the housing stock to condominiums, I am afraid that if this trend continues, there portends a severe housing shortage. According to the regional planning council, the normal market demand in Baltimore County would have the building industry produce about 5,000 units annually, at an average price of $75,000 per unit. This represents annual sales of $375 million.

According to economists at the National Association of Home Builders, the true economic impact of this is found by using a multiplier of at least two times. The full economic impact can then be calculated to be at least $750 million. This means that with building activity off by more than 65 percent from where it should be, the loss to the county is more than $480 million.

Also, according to the U.S. Department of Commerce, each new house represents 1.7 man-years of employment. For Baltimore County, this means almost 8,500 jobs in a normal year; the current drop in building means the loss of more than 5,000 jobs.

I would just add that the generally accepted figure in Baltimore County is that approximately one out of every eight jobs is somehow related to the construction industry, if not in home building itself, then in home furnishings or manufacturing or one of the related areas.

Homebuilding, as well as other small businesses, cannot wait any longer to begin getting interest rates back to reasonable levels. Congress has approved the President's economic program, and it was our hope that once this approval was secured, that interest rates would drop quickly. However, of late, even the administration's economists have been saying that rates will continue to stay high, at least through the end of this year.

We feel that this is an unacceptable situation. We also feel that the current interest rates are much too high, based upon the current inflation rate. The normal spread between prime rate and the Consumer Price Index has been between 3 and 4 points; today, that spread is well over 12 points.

Additionally, we note that credit is being diverted toward nonproductive activities, such as corporate takeovers and the like. We understand that some $35 billion in credit was tied up by the large corporations, merely in the recent bidding war for Conoco.

The other, and perhaps more insidious, effect of high interest rates has been to divert the S. & L. industry into short-term money market instruments. In America, we have traditionally financed our homebuilding industry by our savings and loan industry. Now, Europe is a little bit different.

Now, there are two problems. It is bad enough—the construction industry typically has construction loans and permanent loans; both are bad. The construction loans are typically two points above the prime rate or, at today's rate, somewhere around 22 percent. That is intolerable. But what is more intolerable is the affect on permanent lending, because permanent rates are on the order of 18 percent, and the money is simply not available. There are almost no new housing sales in the housing industry.

In conclusion, Senator, it is our hope that Government can relieve the situation at once. Certainly, I would note that if Government does not resolve it, the voters will make this a number one issue at this time next year. Thank you.

[The prepared statement of Mr. Thaler follows:]

Prepared Statement of David S. Thaler

My name is David Thaler. I am vice president of the Baltimore County Chapter of the Home Builders Association of Maryland. I am here today to protest, on behalf of our membership, the tight money, high interest rate policy presently enforced by the Federal Reserve Board.

Home building, as well as other small businesses cannot wait any longer to begin getting interest rates back to reasonable levels. Congress has approved the President's economic program. It was our understanding that once this approval was secured the interest rates would drop quickly. However, of late, even the Administration's economists have been saying that rates will continue to stay high at least through the end of this year. We feel this is an unacceptable situation.

We also feel that current interest rates are much too high based upon the current inflation rate. I understand that the spread between the prime rate and the consumer price index should be about 3½ to 4 points. Today that spread is over 12 points.

Additionally, we find credit being diverted toward nonproductive activities such as corporate takeovers and the like. We've been advised that some $35 billion in credit was tied up by large corporations in the recent bidding war for Conoco.

There is a feeling among the membership of this Association, as well as others in small businesses, that this whole question of high interest rates is not receiving the kind of attention it should be receiving from the Congress and the Administration.

Here in Baltimore County the home building industry has suffered as deeply as any place in the country. Our production is off 65 percent from normal levels. The July building permit figures show that we took out just over 1,000 building permits during 1981. During a similar period in 1978, the building industry in Baltimore County had used almost 3,000 building permits. The principal cause for this decline has been the high interest rate policies of the Federal Reserve Board.

According to the Regional Planning Council normal market demand in Baltimore County would have the building industry produce about 5,000 units annually. At an average price of $75,000 this represents annual sales of $375 million. And according to economists at the National Association of Home Builders, the true economic impact of this is found by using a multiplier of at least two times (2X). The full economic impact can then be calculated to be at least $750 million. This means that with building activity off by more than 65 percent from where it should be the loss to the county is more than $480 million dollars.

Also, according to the U.S. Department of Commerce each new house represents 1.7 man-years of employment. For Baltimore County this means almost 8,500 jobs in a normal year. The current drop in building means the loss of more than 5,000 jobs.

It is our hope that government can relieve this situation at once. For certainly, if government does not resolve it, voters will make this the number one issue this time next year.

Senator **Sarbanes**. Thank you very much.

Mr. Schnader, please proceed.

STATEMENT OF GEORGE L. SCHNADER, JR., GEORGE L. SCHNADER, JR., INC., BUILDERS, BALTIMORE, MD.

Mr. **Schnader**. Senator Sarbanes, ladies and gentlemen, as a homebuilder for the past 32 years, and a past president of the Home Builders Association of Maryland, I am not here today testifying before you to complain, to tell you about interest rates, or that housing needs are not being met. Nor, am I here about sewer and water moratoriums, because you read the papers and I am sure that you are aware of thest problems.

I am testifying today to try to explain the seriousness of the housing market today, and to give you the opportunity to respond to our situation.

We are not just in a depression in housing, we are not on the way down—we are down. I am not saying "save the jobs" for the plumbers, the electricians, or for the mechanics, the heart of our business, because, for the most part, they are gone.

I am not talking about saving the administration-type jobs, the secretarial, time keepers, sales people, because most of them are gone also. These people are off our payrolls; they are now on the Government and the taxpayers.

When housing starts drop to an annual rate of less than a million and there is a 9-month inventory of new housing, when preowned homes cannot be sold because financing is not available, when small and large builders are rapidly disappearing, when FHA and VA market rates are 16.5 percent plus 8 points, when conventional buyers must pay 18 percent to 18.5 percent interest rates plus 2 to 3 points and have a bank connection on top of this, with no assurance of getting mortgages, when construction mortgages are 3 to 4 points above floating prime rate, the housing industry is as destitute as it can get without being considered completely dead.

When the unemployment rate in housing has reached 20 percent—and, in all probability, will hit a 30-percent level by the end of the year—I think it is pretty clear that the home and apartment industry and allied industries are bearing an unfair share.

The monetary policies of our Federal Reserve Board have been disastrous in the past, and are proving to be even more disastrous now.

A $60,000 mortgage at 1977's rate of 9 percent would have required principal and interest payments of $482.78 an month. At 18 percent, the payment becomes $904.26, or almost double.

The recently passed "all savers act" will do nothing to increase the supply of mortgage funds or reduce the cost of mortgage money. The housing industry simply cannot wait any longer. We must have a reduction in interest rates, unless it is the intent of the Federal Reserve to bankrupt the industry.

Thank you.

Senator SARBANES. Thank you, sir, for a very powerful statement.

First of all, let me ask you how many home builders are in the practice of buying down the interest rate for the purchasers in this area?

Mr. THALER. I would say it is a common practice. I don't know the exact number. Quite a few.

Senator SARBANES. And how does that affect the price of a home that is being sold?

Mr. SCHNADER. Well, it affects the price. You know, you have inventory now, Senator, and you're willing to buy down the interest rates in order to make some kind of a deal, you know, even just so that you can get out with your whole skin. Because, generally a builder, after his construction money is gone, he has no income, unless he is diversified in the apartment house industry and so forth, and has other investments.

But the average builder, on a national level, produces less than 10 houses a year, and this small builder is really being clobbered.

Senator SARBANES. For what period do you usually buy down the interest rate?

Mr. SCHNADER. That would depend, I think, on the deal you make with the lending institution. You may buy a 6-month forward commitment or a year forward commitment. It would all depend how you put your deal together. And then your points may have to be up front, maybe, at the time of settlement. You don't know this.

But many builders in today's market have bought down interest rates, and they're still not selling these houses. Maybe he put a lot of money up front. He has got a 6-month commitment, so he loses that.

Senator SARBANES. Let me ask you this. I have always been concerned about what the ups and downs in home building do to the efficiency of your work force. You talked earlier about losing carpenters and plumbers. And one of the things we want to encourage in our economy is a more efficient production, it seems to me.

What is happening to the homebuilder, in terms of holding on to their skilled work force and keeping it together as a functioning unit, for the purposes of production?

Mr. THALER. One of the most serious problems that home builders recognize is the problem of the warranty, or producing the properly guaranteed product. And the homebuilding industry has attempted to solve that with its home owners warranty program, and the Federal Trade Commission has made certain other proposals.

But the fact is that the boom and bust cycles are so intense in the home building industry that the carpenters and the bricklayers and the skilled craftsmen are laid off during the bust cycles, and during the boom cycles it's very difficult to get equal skill back in time.

The same with the manufacturers. The manufacturers lay off productive capacity during the bust cycles, and are reluctant to put it back on during the expansionary cycles. So it has a very serious effect on our ability to produce a high quality product.

Senator SARBANES. Mr. Schnader, did you want to address that?

Mr. SCHNADER. Well, the history of housing, Senator, has shown—in the last 15 years, we have had four credit crunches; we had one in 1966, one in 1970, one in 1974 or 1975, and this most recent one started in late 1979. And each time, the cost of housing has gone up considerably.

One of the reasons is, as Mr. Thaler has said, we lose our personnel. And you have got to attract these men, and every time you gear up again, it seems like, in this industry, and you take the apprentice boy and try to train him, and you start to gear up, right away you are hit with another money crunch and, you know, you are down again.

Now, most builders, basically, I would say, are out of business. If you build today, with the high cost of money, you are building a monument, generally speaking. And you can't build apartments, because you can't put the figures together.

And if you would take it one step further, and take out—in the permits that Mr. Thaler quoted earlier, that have come in the metropolitan area of Baltimore, if you take out subsidized housing, your permit structure on conventional starts would be way down, because there is very little conventional building today. Most of the building that is going on at the larger jobs are a product of subsidized housing.

Senator SARBANES. I want to pursue this point a little further. I think it is very important, in terms of efficiency and cost in the home building industry. As I understand it, a lot of homebuilders will make a lot of sacrifices to try to hold their working force together, if they can do that.

Would you say that the conditions have been so serious in recent times that most homebuilders are beyond that point—they have simply had to let their work force go and in effect, disband it?

Or are they still trying—and still able, in some instances—to hold it together?

Mr. **THALER**. The unemployment in the home building industry is as serious as we have ever seen it, and most of the good employees have been laid off or have sought other jobs.

I would just add, Senator, that home building is a very long-range form of business. Typically, from conception to the finishing of the final house, it is a 5-year period for an average developer. One that I'm working on now is in its 15th year, and that is unusual, but not that rare.

It used to be that the interest rate moved a quarter of a point a month—a point a year—and that you could predict 5 years from now, with reasonable assurance, what the economic conditions would be. Not any more. The Federal funds rate moved 3 points on Friday. So the short-term conditions are changing much more rapidly than our long-term industry is able to cope with. And in that uncertainty, we are not able to produce.

Senator **SARBANES**. When you go for financing, is the financing not available or, if available, is it at a cost so high that you don't have any customers? Or both?

Mr. **THALER**. There is an agency called the Peak Reports—and it's printed in the Sunpapers—that follows the financing from all the lending institutions.

In answer to your question, briefly, there is no financing around. There are—every week that the reports come out, we see an erosion of the number of open institutions; and the only institutions still available for mortgaging are the very small banks on the Eastern Shore and in western Maryland, that deal with their very small communities.

Essentially, there is no mortgage money available, at any price.

Mr. **SCHNADER**. Senator, I would like to comment a little bit further on that. Essentially, there is no mortgage money.

Now, you know, a builder can go out and he can make a construction loan today, but the lender is going to tie him up so tight that he can't afford it. He's going to put such limits on it. Now, that lender may be willing to make you a construction mortgage above floating prime, but it is very rare in today's market that a lender will commit to the end loan, which is the permanent financing. And this is just not available.

Our secondary markets, such as FNMA and FHLMC, are in utter chaos. As I recited in my speech, when you're talking—you know, on Friday, the points were 8.

Now, I have a subdivision, in Baltimore City, on a $50,000 townhouse. Now, if I close that loan under VA and FHA, on a $50,000 townhouse, I'm going to pay $4,000 to get the mortgage. Now, that's unheard of. I don't have that kind of profit in a $50,000 townhouse.

Senator **SARBANES**. What are you paying?

What is the current cost of a construction loan that you say you can get?

Mr. **THALER**. Construction loans are typically 2 to 3 points above prime, which would put it at 22 or 23 percent today, plus 2 or 3 points origination fee. That is generally available; it is the permanent loans that are essentially unavailable.

To say it again, the homebuilding industry runs, or is financed, on permanent loans.

Senator **Sarbanes**. Mr. Schnader, could you repeat again the figures that were in your prepared statement, on the difference in the monthly payment, related to the different interest rates and the sales figure?

Mr. **Schnader**. Senator, on a $60,000 mortgage, in 1977, with 30-year amortization at 9 percent, the payment was $482.78 a month. Now, at an 18-percent rate, that payment jumps to $904.26.

Senator **Sarbanes**. The same 30 years, I take it?

Mr. **Schnader**. The same 30 years. Now, remember that does not include their taxes and their insurance payment. So, that $904 payment goes over $1,000.

Senator **Sarbanes**. The figures you are giving are just for the interest and principal payments?

Mr. **Schnader**. Yes, sir.

Senator **Sarbanes**. Well, it's no wonder nobody is coming to you to buy homes, obviously, with those kinds of figures.

How do you see the situation of the financial institutions that you deal with?

What concerns do you have in that regard?

Mr. **Thaler**. What we see is essentially what was expressed by the two lenders who appeared before us. The savings and loans are losing money, are suffering disintermediation, don't have any money to lend, and are in chaos. The savings and loans have been the primary source of owner financing during the 1950's, 1960's, and 1970's, during our history.

Senator **Sarbanes**. Do the homebuilders have a concern that the evolution of the financial institutions is such that they may be moving, general speaking, away from financing homeownership, where I think we have done really an impressive job, compared with other countries?

If you look at the percentage terms and the availability of home ownership, what we have done is a major achievement, I think, of this society. I now see developing a trend where there are not going to be any financial institutions whose primary focus is financing home ownership. This will impact upon the homebuilders, in terms of the source and availability of funds.

Do you see that happening?

Mr. **Schnader**. I see the concern about that. The savings and loans basically made home mortgages, and with the recent deregulations, they are almost a commercial bank in today's market. And, you know, they have been burned by the fixed-rate mortgages—let's face it. And as the previous gentlemen testified, you have a negative spread.

So, I see savings and loans going into many other fields, where they now have their powers, and they will put less money into home mortgage financing. I think that is evident. It is there. It has happended. We put the savings and loan industry in the condition it is today.

Senator **Sarbanes**. How much pent-up demand do you see for housing?

Mr. **Thaler**. "Pent-up demand" is a strange term. The theory goes that the baby boom is coming of age and entering its 1930's now, and that traditionally they should be demanding single-family homes, and the traditional accepted number is that the demand is

2 million houses a year, nationally. However, demand is a function of price, and at the current—the assumption of pent-up demand assumes normal housing prices, normal carrying costs.

Because carrying costs are so high, there is no demand. Demand is zero, because nobody can afford to buy a house. Demand is very close to zero.

Senator **Sarbanes**. Now, Mr. Thaler, you talked about this shift to condominiums. Does that require credit, frequently, in order to do it?

What is it that make that feasible?

Mr. **Thaler**. The condominium conversion is being forced along by other market forces. There are no permanent rates, and other rates are so high that nobody can afford to build new apartments. Because there are no new apartments being built, there is no great demand in the existing housing stock, so that rental rates are arising at a very high rate—lower than the Consumer Price Index, but the increase in rents is very high.

Nonetheless, this is constrained by tenant dissatisfaction, and the solution seems to be to convert to condominums, and sell them.

Senator **Sarbanes**. Now, what about your suppliers?

Obviously, this works back upon them and affects their employment situation as well. Does it affect their pricing policy?

Mr. **Thaler**. We found prices beginning to drop. The suppliers are as devastated as the home building industry. The lumber dealers, the brick dealers, the bathroom manufacturers, the tile manufacturers—and their prices are beginning to drop.

Senator **Sarbanes**. Do you want to comment on that, Mr. Schnader?

Mr. **Schnader**. Well, prices are in some—in some phases are dropping a little bit, but not a considerable amount. And once this thing starts up again—and I think we saw this about 30 days ago—the lumber industry produces at something like 35 to 40 percent of capacity. When you saw a strike in the lumber market, you saw prices go up almost $30 to $1,000 overnight, because of the little bit if inventory that is there.

History has shown that once this housing market turns, the housing prices will go up considerably. We saw it from 1975 to 1980, where the price of a house doubled. And you can go all the way back to 1960, when we started these crunches, with the Federal Reserve's irresponsible policies. Each time that you knock the industry down, the prices skyrocket.

Senator **Sarbanes**. Well, this is the boom and bust syndrome that we were talking about before. It affects the cost of your work force, and is also reflected in the cost of your suppliers' work force, as I understand it.

Gentlemen, this has been very helpful testimony, and we appreciate your making yourselves available in order to help us with this effort.

Thank you very much.

Mr. **Thaler**. Thank you, Senator.

Mr. **Schnader**. Thank you, Senator.

Senator **Sarbanes**. I think we will go now to the panel of realtors: Ms. Sara Broadbent; and I understand Bill Byrnes is going to testify in place of Jim O'Connor; and Mr. Robert Schmidt.

STATEMENT OF ROBERT N. SCHMIDT, CHIEF EXECUTIVE OFFICER, RUSSELL T. BAKER & CO., BALTIMORE, MD.

Mr. SCHMIDT. Mr. Chairman, I don't think any of us have any particular prepared statements, but we would like to bring some points to your attention. We appreciate this opportunity to appear before this hearing today. Within the Greater Baltimore area, the amount of resales that took place in the month of July relative to last year were 14 percent below last year in numbers. The dollar volume, however, was off 25 percent.

Now part of the reason for that, of course, is that there are a number of lower priced houses being sold these days for a variety of reasons, one of them being the city bond issue that Mr. Marvel mentioned to you a little earlier, and also the fact that nearly 50 percent of the sales have been properties in which there has been what is frequently referred to as creative or alternative types of financing, which are including short-term secondary notes held by second sellers, sellers subsidizing buyers' payments, negotiating current mortgage holders to grant a rollover at below current market rates and also employer assistance.

Home buyers, right at this time, are faced with monthly housing costs that are double what they were last July, just 14 months ago, when considering the current mortgage interest cost of 17 to 18 percent, coupled with the current increased real estate taxes and insurance and utility cost just 14 months ago, the monthly payments would have been half what they are today.

In July of last year, the mortgage rates got down to the rate of 10 percent. Home sellers are also finding that because of high interest rates for buyers, it is taking a much longer additional amount of time to find qualified buyers. Sales of lower priced homes to first-time buyers have been squenched, particularly, since the latest move just 2 weeks ago, where the FHA-VA rate was increased at one fell swoop by 7 percent, when it went from 15½ to 16½ percent and the point discount to the sellers which was already stated here are running in the 6- to 8-percent category.

The sales of properties with assumable mortgages is a large segment of the volume, but the usury ceiling on second mortgages which is 16 percent is stymieing the ability to have WRAP mortgages which combine the first mortgage existing with a second mortgage to make the payments lower for the home buyer. And the typical husband and wife today in eastern Baltimore County might be where one of the family members is working at Sparrows Point and another might be a part-time nurse and they might have a combined family income of $28,000. If you want to buy a $45,000 townhouse, which is the normal in zone 6, and even though they are being qualified on the basis of 30 to 35 percent of their monthly income, they still cannot afford to buy that price-range house which is still considerably below what is frequently described in the media as a medium house at the $63,000 to $73,000 level.

And so again the home buyers are again bearing the brunt of poor Federal fiscal and economic policy, high deficit spending and excessive slow money growth.

Within the real estate industry itself, the residential real estate brokers are having increased cost, their fixed costs, their CPI indexes for rents, insurance, E. & O. insurance, telephones, advertising, staff salaries and fringes, all of these kinds of things. And there is an inability to pass all of these increased expenses. All costs for operating real estate brokerage offices have been at least as much as the increases in home prices, and the effect, certainly, of the inability to reduce these costs would produce financial hardships on real estate brokers, which reduces profits, which reduces taxes.

A firm that might have had a $100,000 tax liability in 1979, wherein the circumstances of this increased high interest rate prohibiting sales could well mean that that firm would not only not be paying taxes to support the spending, but they would be looking for rebates of their taxes and be doing it in reverse, as a matter of fact.

So the services to the customers have increased. Because it is taking longer to produce buyers, it means that the real estate sales associates are having to take longer time with more expensive transportation. There is a requirement for more advertising at greater expense for longer periods of time. There is an extension of the cash flow to the broker, when he creates a sale, instead of looking to a settlement to occur within 30 to 60 days, may well be looking for a settlement to occur within 60 to 120 days.

And the cost of the training even has gone up because of the need for realtor associate licensees to be much more knowledgeable about all of the variety and kinds of financing that is available today.

Now within the real estate industry we have seen that a number of real estate firms, just as Mr. Schnader alluded to, the numbers of homebuilders are, indeed, finding it necessary to close shop. I personally have had calls from many brokers wanting to sell out. I've talked to a half a dozen in the last 6 months. As a matter of fact, we've acquired three. So we do see that the high interest rates are having an extremely detrimental effect on the home seller and the realtors that are involved in providing this service.

Thank you.

Senator **SARBANES**. Thank you.

Mr. Byrnes, please.

STATEMENT OF WILLIAM J. BYRNES, WILLIAM J. BYRNES REALTY, INC., TOWSON, MD.

Mr. **BYRNES**. Well, to tailgate right on to what Mr. Schmidt said for some hard numbers about brokerage companies that are alive and those that are not. Multiple-list statistics show that the number of members, the number of brokers has decreased by 17 percent from this time last year. You could interpret that to mean 17 companies that have gone out of business. The number of operating offices has decreased by 12 percent, meaning that companies have decided to close an office or terminate a certain activity in a certain area. That represents a very serious problem that we haven't looked at.

I have another point that I think takes us away for 1 minute from the numbers and looks more to the emotional side of home buying, and that is on the FHA-VA interest rate when it was at 13½ a buyer with, let's say, a $2,000-a-month income, $24,000 a year, as we might have had a minute ago, with $20,000 in cash, that person was able to buy in the low $50,000 price range. With the interest rate now, the FHA-VA at 16½, they are able to buy approximately $5,000 less.

Now that doesn't on the surface appear to be an extremely difficult number to cope with, since we have talked about some rather startling numbers. But what that does mean is that the number of available properties from $45,000 to $55,000, based on today's multiple-list current inventory, reduces by 50 percent. So there are half as many houses for that buying couple to look at.

And to me that means a diminished response to the excitement, to the emotional aspects to all of the traditional values that we're used to in home buying. The home-buying process now becomes a very tragic situation rather than a happy one. When your inventory had 1,400 houses to look at, obviously you would not expect all 1,400, but that move in the interest rates reduced that available inventory directly in half.

So without getting involved in economics, looking from the emotional side, looking from the traditional values that we have here of homeownership, we have seen people not in the marketplace, simply because it is no longer fun, it is no longer an exciting great event in the family. The only people who are still in the marketplace are those who have to buy. Those who have to for business reasons or personal reasons who have to move. It is not fun to be in the market, when you work with that kind of person. It really isn't.

So maybe that emotional approach might be of interest.

Senator **Sarbanes**. That's interesting perspective.

Ms. Broadbent, would you proceed as you wish?

STATEMENT OF SARA H. BROADBENT, REISTERSTOWN, MD.

Ms. **Broadbent**. One of the ironies, I think, of the whole situation that we have seen recently, a majority of our buyers are using creative financing that Mr. Schmidt alluded. We rarely have to check with the lenders to see what their interest rates are. It used to be that you would check at least once a week, sometimes twice a week. If you were taking a customer out to show him a home, you would check before you went out.

Today most buyers can't afford it. You don't even have to bother to check. It really doesn't matter whether the lender has the funds or whether he doesn't, because the buyer can't afford to pay them anyway. In using the creative financing, we have seen a lot of sellers who, because of the position that they're put in, are taking back some portion of the funds at a lower interest rate. That seller expects to be paid for that, we have found.

We have found our sellers, when they can offer an assumable mortgage at 9½ percent, a VA mortgage that he knows is assumable, he expects several thousand dollars more than the seller who has the same house that does not have that kind of a mortgage. And as a matter of fact, we have just recently sold two, I personally have, at those lower rates, at perhaps $2,000 more than the market, the lower rates are not helping the inflationary factor, because the buyers are paying the higher prices to get the lower rates.

Senator **Sarbanes**. What you get on one hand, you have to take from the other.

Ms. Broadbent. That's right, and that alos puts kind of a different light on the picture when you are looking at your prices nationally as well as locally, as far as the increase and the inflation on the price of homes. A lot of the reason for this inflation is because we are building and the sellers are building in these factors and the lenders are. When there are 8 points involved on a $50,000 sale, you are talking about $4,000. Actually, that sale was not worth $50,000 to that seller at all.

Senator **Sarbanes.** Well, that is a very interesting point. The Consumer Price Index figure which showed that sharp jump, also showed that a good deal of it relates to housing costs and to interest rates. You get it both ways: the high interest rates become a factor in inflation in terms of the price index and so do the higher housing costs, which are being used in some instances, as you point out, to offset a more attractive mortgage situation.

Let me ask this question: What percentage of home resales today involve some kind of owner financing; has that gone up markedly; and how does that compare?

Mr. Schmidt. I don't have specific figures on that. Within house, we have been attempting to determine that, and it would appear that it is somewhere in the 15- to 20-percent range. Prior to 2 years ago, it would not have been one-hundredth of 1 percent in this Baltimore market to be accepting this as a norm for seller take-back mortgages or even partial mortgages.

Senator **Sarbanes.** If a house goes on the market today without some kind of creative financing, what are the chances of its selling?

Mr. Byrnes. Well, it certainly is diminished. Of course, the converse would be true. The more attractive the owner financing, the more chance it has to sell. It doesn't mean it sells immediately or faster because of what Sally pointed out, but sometimes these houses carry very high price tags, but with a mortgage that—well, let me put it this way.

The existence of an assumable, a straight assumable first mortgage is not always an attraction, because usually the equity that is required by the buyer is so substantial and, as you heard, with second mortgages at 16 percent, that sort of reduces the effectiveness of a 9- and 10-percent assumable first mortgage, assuming that the person had the cash in the first place.

So the only real benefit would be a seller who needs very little of his equity, so this would be the proverbial empty nester or a seller so financially well off that he does not need this money to go on and purchase. That is somewhat unusual, so when you see the special financial flag, usually you have to look. That does not mean an unattractive situation necessarily. It means something that needs to be investigated.

As Bob pointed out, it is a day-by-day business. You cannot look and see what is going on today based upon what went on yesterday. Each day is entirely new, and each listing is entirely new. Seller financing could mean something entirely different.

So it is not that much of an attraction.

Senator **Sarbanes.** Does anyone else want to add to that?

Mr. Schmidt. Just if I may, to make this statement, that any piece of property is going to have a variety of attributes, and certainly, a seller take-back financing under current market rates would be one of those kinds of attributes. Others would be the norm in the marketplace. The condition, the location, the particular type, style and the value, and if, in fact, there are additional buyers coming in from out of town with the attraction of additional industries in Maryland, and where there are some instances that an employer will be called up to subsidize the purchaser's mortgage, than that kind of buyer is going to be attracted to this house that may be on the market under this alternative, extraordinary financing.

Senator SARBANES. That leads right into the next question I wanted to ask, which is how families that must move, because of company transfers or perhaps a military transfer or some other comparable situation are being affected by this situation?

Ms. BROADBENT. We just recently sold a house that had been on the market for close to a year. The people had been transferred. They had been living in Illinous. They had a house they wanted to buy they could not buy. They had been paying rent plus mortgage payments here. They walked away, taking $5,000 less than what they paid for the house a year ago, simply to get out from under the pressure of two payments.

And this is not unusual when you list a property today. When we listed a property 2 years ago, we would certainly expect it would be sold, if it was priced right, if the condition was good and the location was reasonable, within 3 months.

When you list a property today, unless there is something extraordinary about it, you have got to be looking at 6 months and maybe longer.

Senator SARBANES. Six months, 6 to 9 months?

Ms. BROADBENT. Yes; and anybody who doesn't prepare a seller for this in today's market isn't doing the job right, in my opinion.

Mr. BYRNES. The transferee usually will not make the move at all, unless there is some assistance by the corporation. A recent transferee bought a home in New Jersey. The only reason why he made the move at all, aside from career goals, was that he received what was known as a mortgage interest differential factor. So the company subsidizes the difference between what he had and what he will have, and they do this for a couple of years perhaps, or maybe for the life of the time he's on the job, meaning that if there is not any economic benefit, aside from just as I said, salary and career, they won't make the move at all.

Now these extra costs—a recent conference I attended had the cost of a transferee move doubling in the last 3 years. These costs to move these people are passed on to you and I. There's no question about it.

So unless there is some economic benefit besides the job, they won't move at all.

Senator SARBANES. what percent of the companies make that arrangement, would you estimate? Do you have any feel for that?

Mr. BYRNES. I would say that there are none that do not.

Mr. SCHMIDT. I feel that the larger—all of the larger corporations do. Some of the smaller ones will have individualized kinds of things. They won't have as much a blanket arrangement with their total staff, but they will individualize them, depending upon the characteristics of that particular employee.

Senator **Sarbanes**. Of course it then becomes a disadvantage that smaller businesses face in attracting talent in competition with the larger concerns which are able to provide this subsidy to the employees they are trying to attract.

Mr. **Schmidt**. That's right. I've seen statistics that indicate that somewhere over 70 percent of the major corporations do provide this kind of subsidy for their employees. And today that is being included for what they call "new hires," as well as those that are being transferred, current employees being transferred. And they are making programs as well, here in Maryland, if a corporation is going expand and it wants to bring in a "new hire," as it's called, from out of State, doing the same kind of thing for him or her as well.

Senator **Sarbanes**. Mr. Byrnes, I was interested in your description of the whole attitude which now prevails as you try to do business. How much embitterment do you encounter amongst people who are seeking a home on the one hand, or among sellers on the other, when they confront these situations and aren't able to proceed in what they would regard as a reasonable way?

Mr. **Byrnes**. Well, it is present. It really is. It is very difficult to go to a seller today, to tell the seller that despite our talents and our abilities, it is going to take 6 months to get the house sold. They can't believe that. It is very difficult to go to a buyer who has his goal set way up here and finds them diminished substantially.

I think our industry has done a very good job of attempting to get away from the problem that is referred to as sometimes a blaming the messenger for the message. The message is quite clear that housing today is a very, very expensive situation. We find resentment, not directed to us necessarily, but to those who control, those who are pulling the strings. Like "Why does there have to be a 16½ FHA rate with"—as I left my office—"6½ discount to the seller. Where is the logic? Where is the intelligence in this?" It is not there. So the resentment is based not necessarily at our sales people or ourselves but to those who write the economic and the fiscal policy of this country. "It just doesn't make any sense."

So we help them. We sooth it. We try to get the emotions out of the decisionmaking and bring it more into the fiscal situation which it now is. And the buyers buy and the sellers sell, neither one of them ending up with what they wanted or what they had looked for.

So that is how we have handled. It is still there though. You answer the phone and have someone ask what the price is. They can handle the price, but then to ask what the monthly payment will be, as we're prepared to do. For instances, I'm looking here at a Baltimore County $75,000 house, which is below average. The monthly payment, principal and interest with 10 percent down is $1,125 a month and that requires an annual salary of $54,000 to buy.

And that's not Montgomery Country and that's not California. That is across the street. That causes the resentment. That is where the people who come—they can't believe that number.

Senator **Sarbanes**. Well, thank you very much. You've been a very helpful panel and we appreciate it.

There have been some changes from the announced list in the small business panel. Hallie Rice, the vice president of the Small Business Council of the Baltimore County Chamber of Commerce, and the president of EIL Instruments of Sparks, Md., is out of town, and his testimony will be presented by Robert Cannon, who is president of the Baltimore County Chamber of Commerce.

And we also have with us Raymond Seager, chairman of the Small Business Council of the Baltimore County Chamber of Commerce and president of the Mary Proctor Tables Corp., and James Grady, who is chairman of the governmental relations of the Small Business Council of the Baltimore County Chamber and the owner of Woodbrook Exxon in the 6200 block of North Charles Street.

I understand business obligations keep Ms. Dorsey from being with us.

Gentlemen, we are very pleased to have you with us and to have this opportunity to hear from the representatives of the chamber and particularly of the small businesses council. Mr. Seager, I think we will start with you.

STATEMENT OF RAYMOND H. SEAGER, PRESIDENT, MARY PROCTOR TABLES, INC., AND CHAIRMAN, SMALL BUSINESS COUNCIL, BALTIMORE COUNTY CHAMBER OF COMMERCE, BALTIMORE, MD.

Mr. SEAGER. Thank you, Mr. Chairman.

I am Raymond H. Seager, president of Mary Proctor Tables, Inc., and chairman of the Small Business Council of the Baltimore County Chamber of Commerce.

The small business council represents 85 percent of the chamber's 500 members.

If I may be blunt, high interest rates are driving many small businesses to the wall. Let me cite a few critical potential consequences of high interest rates:

Plans to replace necessary plant and equipment will be postponed and or abandoned. Reduced ability of business to expand; impacts upon those seeking jobs, particularly minorities and other disadvantaged groups. For many, current interest rates threaten even survival profits, let alone profits that are enticing enough to attract investors. Letting small business fail can lead to reduced levels of competition, with potential disadvantages for the consuming public. High interest rates limit our domestic firms' ability to compete with foreign competition. Consumers lose when free customer services are discontinued.

That concludes my statement on behalf of the small business council. And at this time I would like to address the impact of high interest rates on my business.

Mary Proctor Tables is a small manufacturing company, located just over the city line, in Baltimore County. We are well within the Federal Government's guidelines of being a small business and feel we are representative of many of the Nation's small business community.

We employ 50 skilled and semiskilled persons, including supervisory personnel. MPT has been active in employing minorities, handicapped, ex-offenders, and economically disadvantaged.

We are considered an old-line company because the products we make are in mature markets within the housewares industry. Our products, mainly ironing boards, are dependent on new families and new households.

As a small firm, we are seriously affected by high interest rates, as outlined below:

One, conventional bank borrowings are almost impossible for smaller firms due to deteriorating profits and declining net worths. Banks turn away from small businesses in times of difficulty and tight money, turning to the large, less risky, publicly held corporations.

Two, venture capital companies and SBIC's are looking at high technology companies because of the potential stock appreciation, thus they ignore the old-line companies who for years have contributed to our economy.

Three, accounts receivable and inventory are financed through factors who raise and lower rates based on a prime rate. This seriously diminishes our cash flow and ruins our competitive position when larger competition is paying less than prime and we pay 5 points over prime.

Four, materials and material handling costs become higher, and we must adjust our prices accordingly. If we raise our prices too high, we will lose our customers to our better-financed competition, whose borrowings are more favorable and able to absorb high costs for a longer period of time.

Five, the higher the interest rates, the lower our profit and return on investment. Therefore, individual investors have no incentive to invest in small, old-line firms when they can get 17 to 20 percent return in money markets and avoid the risks and headaches of small business.

In summary, small business will fall by the wayside if high interest rates continue to impact:

First, profits,

Second, ability to attract equity investment and conventional financing, and

Third, competitive pricing practices by larger competitors.

The demise of small businesses and related jobs will only create greater pressure on social-economic problems for the entrepreneur, the economically disadvantaged, and the Nation.

I feel small business has been the backbone of the country's economy and we need an action plan.

Thank you for your interest and the time you have taken to listen to the plight of a typical small businessperson in these difficult times.

Senator **Sarbanes**. Thank you, sir.

Mr. Grady.

STATEMENT OF JAMES GRADY, OWNER, WOODBROOK EXXON, BALTIMORE, MD.

Mr. **Grady**. Yes, Senator. Thank you.

I operate the Exxon service station on Charles Street, just north of the city line. I went into business in the spring of 1979.

Most of the capital that I put into it for inventory and working capital came from savings I had accumulated in a previous career.

But I was determined to bring a modern car care center to the Charles Street area, so I did take a loan to invest in some electronic equipment for engine analysis, front end alinement, wheel balancing, and that type of service.

I went through my books over the weekend and pulled out a few examples.

I took this loan out on April 27, 1979, at an interest tied to prime. My first payment was due on June 1, 1979, at 10½ percent. My 12th payment was due on May 1, 1980, at 18.25 percent, the same loan. The payment that is due tomorrow, the 28th payment—thank goodness the principal is down—is at 20.75 percent. It's the same loan. I did not plan on that. That is one of the few things I planned on when I went into the business. In my generation, growing up, that was the kind of interest you expected to pay if you borrowed from the Mafia. I have a dilemma with these high interest rates.

I should now invest in two more pieces of equipment, advanced engine analysis that now is designed to measure carbon monoxide and hydrocarbons. And although Maryland does not yet have a law in place to measure these poisonous emissions, I am in the kind of a neighborhood where a great number of my customers would pay annually, or periodically, to have such service, not just for the environmental advantages, but proper emissions means maximum fuel economy. In today's market, that is just as important.

The various pieces of equipment that I have looked at for this run between $15 to $23,000. Now, the dilemma is: I have been successful; I have almost enough money to buy this equipment invested in CD's and money market certificates that are earning 13 to 17½ percent; do I cash those in and take the rest out in another 21 percent loan? Because if I do, will I make enough return on this investment that I'm losing and paying, which to me is just an investment in the use of money.

At 10 or 11 percent interest, I wouldn't hesitate to make the investment. And it would stimulate the economy, because I would be buying it from a Maryland firm, like Sun or Marquette or Allen, but not just me, not just one dealer. There are a couple of hundred dealers in Maryland that are in this boat, and probably 1,000 or more across the country.

A second piece of equipment is my tow truck. It is—the one I'm using is approaching 7 years of age, and it is becoming a liability out there on the road. Now, this is a $20,000 investment. Between—half of it would go to Ford or GM for the body, and the other half to the people who build, locally, the superstructure. Again, other dealers are facing this.

As a consumer, until 1978, I traded an automobile every 2 years. I would keep a 24-month loan, renewing it at the bank. I haven't done this in the last couple of years, and I don't know what it is going to lead to in consequences. Fortunately, today, I can take care of them at cost.

But I have, about 300 customers that are doing the same thing—that in the last 18 months they haven't bought new cars—instead, they're bringing them into my shop for repairs. And lower interest rates might not hurt that. I'm not that worried about it. I have the kind of business that I still have people waiting to come in for service.

Finally, I was feeling sorry for the previous speakers, because I am probably driving the real estate people in my business area nuts. I look at every new house that comes on the market there because I would like to move closer to my business, but I am not going to give up a 7 percent mortgage out in Phoenix for a 14 to 16 percent mortgage here just to be closer to my business, even though—its easier on the nerves than driving in traffic—the energy advantage, the environmental advantage would be there. It is just not monetarily worth it today.

Senator, these are the problems. I'm not an economist. I don't pretend to know what the answers are. But I can sincerely say that, in my limited and personal way, if the interest rates were half of what I'm paying right now, thousands and thousands of dollars would change hands right in my own environment.

Thank you.

Senator SARBANES. Thank you.

That was a very perceptive statement. You may not be an econimist, but you, obviously, are a very practical man.

There is difficulty in the framework in which people are operating, obviously, it does not square with the practicalities of how they would conduct their daily business in the ways you just outlined. I will return to that in the question period.

Mr. Cannon, why don't we hear from you?

STATEMENT OF ROBERT CANNON, PRESIDENT, BALTIMORE COUNTY CHAMBER OF COMMERCE, BALTIMORE, MD.

Mr. CANNON. Senator Sarbanes, it's my pleasure to be here today.

I am here as president of the Baltimore County Chamber of Commerce. I am pinch-hitting today for Hallie P. Rice, president of the E.I.L. Instruments, Inc., who is a member of our board of directors and a vice president of the chamber, charged with the responsibility for small business.

Mr. Rice has prepared a statement, which I would like to take excerpts from, and which we have delivered here today.

Senator SARBANES. Fine. We will include the prepared statement in full in the record at the end of your testimony.

Mr. CANNON. I'm just taking certain selected portions that I think are worth calling to your attention.

Essentially, he describes E.I.L. Instruments and its history and says that the harsh economic business environment small business finds itself in today is the result of Government intervention and strangulation of free enterprise.

He further recites the history of his having built his business over the last 10 years, almost entirely upon debt financing, and points out that small business generally obtains its funds from two sources, either debt financing or retained earnings.

Mr. Rice highlights in his statement the fact that, as a small businessman, he feels that small business has been discriminated against by Congress in the various tax benefits that have been made available to the business community.

He lists six or seven specific types of incentives that Congress has provided to business and says that, in effect, only one of these is available for the small business industry.

Pointing out that, even under the Economic Recovery Act, small businesses will still continue to pay something like 48 percent or more of their total earned income to both the Federal Government and State governments as tax.

He then points out, by comparison, his investment in five publicly-held, large companies, and points out that the total taxes they pay, as a percentage of their income, is significantly smaller than those E.I.L. and other similarly situated small businesses pay.

And obviously, he is making an appeal to Congress for more legislation that would permit and provide more incentives to small businesses, so as to reduce the amount of borrowing necessary for them to fund their investments.

Pointing out the impact of high interest rates on his operations, but said it could be diminished if Congress would provide comparable incentives to small business so as to reduce their need to borrow and have retained earnings available to help in that purpose.

That all the legislation that has been passed during the last 5 or 10 years to provide relief from taxes has been addressed to large businesses.

He then points out, based upon the experiences of his own company, what I would characterize as over Government or reporting requirements imposed upon a company like his. Because of Federal requirements, and the requirements of the various States in which they do business, they currently have to prepare and submit over 300 different kinds of tax reports annually.

Now, I know Mr. Rice and I know the way in which he does business, and he says he believes that they suffer penalties on at least 15 percent of those because of the inability to keep up and meet the deadlines that are imposed by all of the different governmental agencies that they have to report to.

He summarizes his report by saying:

First, reduce the cost of government at all levels. That will lead to an eventual reduction of the multitude of the State, county, and municipal taxes.

He also appeals to have small business have an opportunity to retain a much more significant portion of its earnings, as Congress has done for large businesses, to provide the working capital to finance the growth through retained earnings and thereby diminish their need to rely upon borrowing at the prime, or, as Ray Seager points out, 5 points over prime, as many of the small businesses have found it necessary to do.

Independent of Mr. Rice's statement and based upon my own experience, both within the chamber and in the practice of law, I believe that incentives are necessary from the Federal Government, as well as from local governments and State governments, in order to meet the crisis that is at hand.

The industrial revenue bonds I know Congress is looking at. I, for one, find that any kind of incentives that provide jobs are going to make huge returns to Government, both at the local, State, and

Federal levels. And I certainly encourage the continued use of industrial revenue bonds to create jobs.

I think something comparable is necessary for the housing industry, because I think there is a crisis like one we have never seen in the housing industry. And I, for one, cannot see any solution to that in the near future.

The ripple effects of that upon small business, the entrepreneurs, the carpenters, the plumbers, the electricians—all of these entrepreneurs who demonstrate the pioneer American spirit, they are just being crushed.

There will be no one but the conglomerates left unless Government steps in to provide affordable housing and to provide jobs for the unemployed. I think these are essential. I don't think they are moneys that are not well spent.

I think that experience shows that, for example, UDAG grants in appropriate areas, when leveraged with private investment, have served as tremendous incentives—these are not just Government funds that are being squandered.

That concludes my statement, Mr. Chairman. I am sure my associates with the chamber would be pleased to answer any questions that you may have.

[The prepare statement of Hallie P. Rice, together with attachments, follows:]

PREPARED STATEMENT OF HALLIE P. RICE

Thank you for the opportunity to appear at the subject hearing. Unfortunately, a prior business commitment makes it impossible for me to attend in person but I am taking this opportunity to submit my comments in a prepared statement.

The harsh economic business environment, particularly Small Business, finds itself in today is the result of many years of Government intervention and strangulation of free enterprise. I believe I speak with some degree of experience and authority as indicated by the attached items of recognition:

(A) Congressional Record, May 12, 1976—Hallie P. Rice, Maryland Small Business Honoree by Honorable Clarence D. Long.

(B) EIL Instruments, Inc.—a portrait of its founder, Baltimore News American, Sunday, August 16, 1981.

As one who built his business for the past ten (10) years entirely on debt financing, I am acutely aware of the impact of interest rates; but I do not believe it is the most restrictive element in the success or failure of a small business. Interest is an expense of operations before taxes and usually analyzed as a percent of sales. Companies' growth are sustained by the addition of funds necessary to finance receivables, inventory and, to a lesser extent, purchase of assets (machinery and equipment). Small private businesses obtain these funds from two source, i.e. retained earnings and borrowed money (debt financing).

What a Company has left in retained earnings is controlled and legislated by Congress who votes various tax benefits to help companies defer or eliminate taxes thus strengthening their working capital position. Benefits that currently receive much publicity are listed below:

(A) Investment Tax Credits.
(B) Targeted Job Tax Credits.
(C) Deferred Taxes for a DISC (Domestic International Sales Corporation).
(D) Accelerated Cost Recovery System (Depreciation) 10-5-3-Rule for rapid depreciation.
(E) Extended 15 year rule for carryover of Losses and Investment Credits.
(F) Research Credits.

Do all of these Tax Credit Provisions help Small Business? Let's look for a moment at the facts.

Under the new Economic Recovery Act, any small business with taxable income of $100,000 is, and will continue, in the 46 percent Federal Tax Bracket and at the usual 2 percent State Income Tax and you arrive at the fact that Small Businesses that are successful are paying 48 percent or more of their total earned income to the Governments as tax, leaving them retained earnings for growth about 50 percent of what they earned.

Some limited facts that I have put together would surely indicate that legislation is focused to help the politically influential large businesses. Shown below is a random sampling of the net income taxes paid by five companies I happen to be a stockholder in. I pulled their annual reports for 1980 out at random and you can see that the taxes they pay, because of various benefits, is incredibly less than small businesses:

Total taxes paid as a percent of income

Company:	
The Hoover Co	19.4
Ball Corp	37.8
General Portland Co	38.0
PPG Industries	41.7
Union Carbide Corp	33.6

This speaks to the point that legislation addresses itself to the need of capital intensive businesses and not to the small emerging business that is personnel and service oriented. If you will search the list of legislated tax benefits above, you will find only one that gives any relief to the small business and that is Item B "Targeted Job Tax Credits" and, as you are probably aware, this has been legislated out by 1983. Originally it had a maximum tax credit of $50,000 so you can see that it never had any impact in a large company but had very significant impact in small businesses and was a strong incentive for us to try to hire disadvantage individuals.

In the area of Investment Tax Credit, this benefits the company that makes, and must make, major investments in machinery and equipment. Again, small businesses are service-oriented, generally speaking, and invest in people. The next area is the tax benefits derived from DISC's. This is an interesting area and, as small businesses emerge, they look over the horizon to the opportunities to sell internationally but certainly, until you develop a national identity, you do not attempt to establish an international business. The recently passed Accelerated Cost Recovery System again benefits the company that has made major investments in buildings, equipment and automobiles and permits them to accelerate their depreciation and derive tax benefits.

The extension to 15 years of the carryover of losses and investment credits again has no direct concern to a small business.

And lastly, Research Credits, as the law is written, is going to be very difficult for use to find an arena to conduct the research and to do the documentation that is required.

Without retained earnings, the small business does go to the bank and does have to do debt financing. And, at unrealistic interest rates, he is thwarted in his plans. But, the long-range solution to this problem is giving the enterpreneur the opportunity to retain his earnings and grow internally. This is certainly what we are hoping the private sector will do rather than continuing to increase their debt.

My point, is summarizing this section, is all of the legislation that has been passed during the last five or ten years to give business relief from taxes and preserve their retained earnings have addressed themselves almost exclusively to large businesses.

The other arena that completely submerges the small businessman, as he tries to gain a foothole in his area of expertise and function within our bureaucratic society, is the tremendous pressures that are put on him in the area of tax reporting and tax compliance. Think about a small business, like our company that has distribution outlets in eighteen States. This requires monthly reporting on sales tax, on unemployment tax, or workmen's compensation, etc. Take this one step further and each State, as well as County, and very often municipality, has franchising tax reporting, personal property taxes, business license, various nuisance taxes, etc. As a small company located here in Maryland, we are submitting over three hundred tax reports annually and probably receiving penalties of 15 percent of them because they are filed improperly or they are filed late. The sheer magnitude of controlling and managing this tax reporting is very difficult. We estimate that somewhere between twelve and fifteen percent of our total labor dollars spent in our accounting department is spent to prepare and respond to tax requirements—either preparing the returns or spending intermindable hours with auditors, whether it is on State Sales Tax, whether it is on FICA, or whether it is on Government Withholding, all of them require audits and audits take time. I guess I'm just grateful that may customer base of 95 percent industrials don't audit me for everything I do.

In summary, first reduce the cost of Government at all levels; this should lead to eventual reduction of a multitude of state, county and municipal taxes. Giving small business the opportunity to retain a much more significant portion of his earnings (as Congress has done for large business), will provide the working capital to finance growth thru retained earnings and use the banks for short-term financing rather than a permanent source of funds.

Attachments.

[From the Congressional Record—Extensions of Remarks, May 25, 1976]

HALLIE P. RICE—MARYLAND SMALL BUSINESS HONOREE

(By Hon. Clarence D. Long of Maryland in the House of Representatives)

Mr. LONG of Maryland. Mr. Speaker, Hallie P. Rice, founder of E.I.L. Instruments in Timonium, Md., has been named Maryland's Small Business Person of the Year. He will be honored, together with other State Small Business People, at a reception this Thursday, May 13, for Members of Congress to meet Mr. Rice and other outstanding representatives of the more than 13 million small business entrepreneurs in this Nation.

Mr. Rice, who was raised in Alaska, attended Reed College in Portland, Oreg., and was graduated in 1945 from the U.S. Naval Academy. He holds a master of science—physics—degree from the Catholic University of America.

The company he founded, E.I.L. Instruments, Inc., was started in part with funds guaranteed by the Small Business Administration. Having repaid that initial loan, Mr. Rice has continued his business efforts with the assistance of another loan partially guaranteed by SBA.

In the 6 years of E.I.L.'s existence, it has had an annual growth rate of 25 percent. Sales are estimated at $5 million this year.

E.I.L. is headquartered in Timonium, but has seven branch offices—in Maryland, Chicago, Indianapolis, Pittsburgh, Ohio, Rhode Island and Virginia. The firm specializes in the sale and service of electrical and electronic test equipment, and has outbid large competitors, including Honeywell and General Electric for Federal contracts to provide an "on-call" service for Federal installations. The firm has also been involved in work at the Calvert Cliffs nuclear powerplant in Maryland, where it provided nuclear instrumentation testing.

Mr. Rice and his firm have achieved a remarkable success. Meanwhile, he has been active in the community, serving as a vestryman of his Episcopal parish, as a member of the advisory board of the College of Notre Dame of Maryland, in the Naval Academy Alumni Chapter for Baltimore, and as a member of the Engineering Society of Baltimore.

I am proud to bring Mr. Rice's achievements through his own efforts with the encouragement of the Small Business Administration to the attention of my colleages. I am especially proud as Congressman from the Second District of Maryland to represent Hallie Rice and his family.

[From the Baltimore News American, Aug. 16, 1981]

E.I.L. INSTRUMENTS INC.—A PORTRAIT OF A FOUNDER

(By Ellison Moss)

Ten years ago Hallie P. Rice, then at the age of 48, decided to take a calculated risk. He bought a small firm that distributed electrical process instruments with $200,000 capitalization.

Today that company, E.I.L. Instruments Inc., does in excess of $20 million a year; it has moved into its own building at the Loveton Center in Sparks, and it maintains 350 employees nationwide and in Puerto Rico—120 of them in its Sparks headquarters in the Loveton Center near Hunt Valley.

While the fortunes of the company are varied and its figures show dramatic changes, the background of the company founder, Rice, is essential in telling the story of E.I.L. Instruments.

He was born in Juneau, Alaska, in August 1923. He attended local schools and Reid College in Oregon and later, won an appointment to the U.S. Naval Academy at Annapolis. He graduated in 1945.

The three years he spent at the academy—it was during World War II and the academy had an accelerated course—were his start of his love affair with the Free State.

Rice left active naval duty in 1955 as Lt. Commander but remained in the naval reserve and recently retired as a captain.

From 1955 to 1963, Rice worked as a manufacturer's representative selling electrical products.

It was in 1963 that he bought a small "Ma and Pa" business which was in the 2000 block of St. Paul St.—a business that was begun in 1945 and run by a man named Edgerly who called his operation "Edgerly Instrument Laboratories Inc."

"He didn't like to go out in public and meet people. He was happy just tinkering around in his shop," Rice remembers.

The business repaired analog meters.

Two years later Rice was approached by Baltimore-based Unitec Industries, a conglomerate, and he sold them his business and went with them as an employee.

"I learned the ropes working there, and most importantly I learned what not to do." Rice said.

But Unitec overextended itself and "began to fall apart," Rice said.

"That was in 1970 and so, with a small group of investors, I bought my company back, By then I knew what I had to do and how to do it. During those five years I saw the mistakes others made and I learned not to make the same kinds of mistakes.

"I learned in the 'school of hard knocks' and I went to school and took management courses."

In 1970, the company whose name was changed to E.I.L. Instruments Inc., had sales of $1.511 million.

In its early years, E.I.L. serviced, repaired and calibrated electrical and electronic test equipment and to a limited degree, customized analog panel and switchboard meters. But the Rices also sought to reorganize the firm along clear-cut lines of profit center responsibilities and to create the foundation for both geographic growth and expansion into related areas.

For its fiscal 1980, the company had sales of $20.019 million, a 33 percent gain over fiscal 1979. The firm's 10-year annualized growth in sales has been 33 percent.

This year Rice and his board of directors decided to go public with a stock offering that was put together by Baker, Watts & Co., a Baltimore investment firm, with the date of the prospectus set at April 8.

The company offered 300,000 shares of its common stock at $12, yielding $6 million to be used for expansion and other purposes. It is traded Over-the-Counter in Baltimore.

Its stock was quoted this week at 7¾–8½, a respectable quotation for a just issued stock, according to Baltimore investment brokers.

The company, which spent considerable time this year in the decision-making process of going public (company control remains with insiders, since the stock sale represented 19 percent of the company's total) has projected its sales for fiscal 1981 will reach $23.5 million.

Its profits for the prior fiscal year were $745,872, or $1.96 a share, up 34 percent over 1979 profits of $555,600. The firm's annualized earnings growth has been 33 percent in its first decade of operation.

Rice sees a 17 percent growth for the firm this year, not as much as in previous years because of the time spent on going public.

He also credits his advisors with the tremendous growth of his firm, a growth that prompted *Inc.* magazine, an industrial-financial publication, to place E.I.L. in with the top 200 growth companies in the U.S.

"Part of my 10-year plan was to control our growth. At the end of the 10 years I determined that if we'd made it all right then we'd go public and that's just what we did."

The company's manufactures electrical instruments which accounts for 10 percent of sales. Its manufacturing includes state-of-the-art electricial test equipment, often of proprietary design. This equipment is sold to industrial firms, electrical utilities, independent testing companies, service shops and government agencies.

These units are primarily used in testing protective devices associated with electrical distribution systems.

The other 90 percent of its business involves distribution of electrical equipment through 18 sales and service centers in the U.S.

It sells analog and digital panel meters, testers and related instruments from 29 leading manufacturers. Shipments are usually within 24 hours from local inventories.

It also modifies or customizes this type of equipment for customers.

An international division will be added soon.

Rice said the company also operates in the Middle East and in Africa and uses various U.S. exporting companies to handle products in South America and the Far East.

Rice who like President Reagan enjoys jelly beans and has two containers in his corner office, is a solidly built man who has kept his trim figure and athletic ways.

He participates in the Annapolis-Newport and in the Bermuda yacht races. Rice has also sailed his own vessels including a Ludders 44 and most recently, a Morgan 34-footer and is now perusing yachting magazines seeking to buy another sail.

He has some leisure time these days, but not much.

Senator SARBANES. Thank you very much.

I might add something on the UDAG grants, because that is something we have tried very hard to preserve. We have succeeded to a limited extent, the Maryland ratio on leveraging was the best in the country. We did a more successful job in the State of drawing in private dollars, in relationship to the public dollars involved, than any other State in the Union. We reached 6 to 1, on our leveraging, which was quite an accomplishment and really a tribute to what had been put together to serve as a magnet to drawing the private funds.

Mr. CANNON. It does prove that if the seed money is there, it will attract risk money from the private enterprise and that it does work if managed properly.

Senator SARBANES. That's right. And without the seed money, there is frequently not enough catalyst to bring it all together.

And frequently the consequence of that approach is a public-private partnership, in trying to solve a problem, which I think is highly commendable. My own view is that too often we see the public and private sectors as in conflict with one another, instead of appreciating the real opportunity for a cooperative venture, where the public sector accomplishes what it is uniquely able to do in providing basic infrastructure, and then the private sector is able to take that framework and move with it.

Gentlemen, there is one point you made that I think is very interesting. Mr. Grady outlined in particular detail and, Mr. Seager, you mentioned it, too. It is thus: If you have funds to invest in your business—and let's assume that for the moment, although I know it is a very big assumption for a lot of small businesses—do high interest rates create a conflict in your mind over whether you ought simply to put the money out on loan at the high rates rather than invest it in further development of your business, particularly if—as in Mr. Grady's case, I understand—you must both invest your own money and forego the higher return and borrow in order to make up for the package and the high rates.

How common is this conflict in thinking among successful small businessmen, who are in a position to make an investment?

Mr. GRADY. In my own industry, Senator, talking to other dealers—because I do represent them in a trade association, also—the impact it has is they are waiting until they absolutely are forced to the wall to make the change, to make the investment.

Senator SARBANES. Which may not be the most efficient way to work.

Mr. GRADY. Of course, it's not.

Mr. SEAGER. I think that in small business you're finding that—especially where there is older management—the individuals are selling their businesses or they are liquidating them, and they are putting money into the money market funds, either because they are tired of the hassle or the next generation says, "Hey, this is a better investment by doing this."

So, I think you're seeing more and more small businesses that have been successful liquidate, not only in Maryland but throughout the country.

Senator SARBANES. And we're not talking now about the marginal people. We're talking about those who have been effective and productive, I take it.

Mr. SEAGER. The marginal people don't have much to sell.

Senator SARBANES. Do you agree with the National Federation of Independent Business Survey, that interest rates and financing is now the single most important problem facing small business currently?

Mr. GRADY. I think it is neck and neck with unemployment insurance and workmen's comp rates.

Senator SARBANES. Do you mean the carrying charges you have to pay with respect to unemployment?

Mr. GRADY. Yes; I pay over $8,000 a year for that alone, and I haven't had an accident since I've been in business and I haven't fired anybody.

Senator SARBANES. You sound like a good employer, I must say.

Mr. GRADY. I'm careful who I hire.

Senator SARBANES. Well, that's part of being a good employer. Mr. Cannon.

Mr. CANNON. I would agree that it is, because it all gets channeled into the bottom line and the enormous carrying load of debt is the thing that is going to—well, that has cost so many in the housing industry and other related industries. It cannot go on as it is.

Senator SARBANES. I think your point about debt financing is important.

I was involved in enacting legislation to make it easier for venture capital companies to function as small business investment companies. As Mr. Seager pointed out, their focus tends very much to be in the high technology area. But in the course of those hearings, it was brought out very clearly, that small business, as you point out, is almost entirely dependent upon debt financing and on retained earnings.

The difficulty of access to equity financing is something that simply exacerbates this problem.

The fact is that the high interest rates have a greater impact on small businesses than on large companies, and therefore increases the competitive disadvantage at which small business functions.

Mr. SEAGER. It has become a two-tiered system almost.

Senator SARBANES. Besides banks, what are the other sources of credit to which small business looks?

Mr. SEAGER. They look toward the collateral lenders and also private investors, SMIC's, ventue capital.

In most cases, because of the high interest rates that are being paid in the money market funds, we are finding it very reluctant for investors to come aboard.

Senator SARBANES. Are small businesses finding that in those instances where they deal with large companies, either as suppliers or as purchasers, the large companies, given the high interest rate situation, are shifting the float in such a way as to maximize their own position in holding the money either at one end or another end—in effect, throwing the burden back on the small business? Are you encountering that?

Mr. **Seager**. We are finding it both ways. The lenders are tightening their credit terms. They are also able to pass their price increases through to small businessmen, not necessarily large business.

Large businesses have the leverage, and they are able to delay some of the price increases; so, you have that as a factor. Plus, they are tightening down on terms.

On the other end of it are your customers, where you have, in our particular case, large retailers—you find them going out further and further as far as their payments go.

Senator **Sarbanes**. So, you are carrying them for longer than was previously the case?

Mr. **Seager**. Plus, you are finding, are deductions, unauthorized deductions much greater. So, you are getting the small business person, who is getting caught right in the squeeze, with the vendor tightening down and passing through price increases, shortening terms; and the large retailers, on the other hand, extending out, taking unauthorized deductions. It may take you 6 months to 1 year to try to get that money back because, again, you don't have the staff to do the work and continue to be on top of them. You don't have the leverage to say, "OK, if you don't pay in 30 days, we're going to put you on hold." It might be your largest customer. It might take 60, 90, 120 days.

Mr. **Grady**. Both of the questions you posed on the source of financing in the service station business. There are some manufacturers of equipment that will now come in and allow you to rent the piece of equipment at a very high rent, but it is an expense item for 5 or 6 years. And then for a nominal 2 percent or so, you buy it used, and it is yours on credit. On credit in our industry, mostly we had one major supplier, the one who supplies us motor fuel.

And what is happened is, in the 2 short years that I've been in business, the cost of fuel has more than doubled the investment each dealer has in this business. When I started out, the gas I had in the ground which I must pay for and the credit card float, which I used—where I used the company's credit card, it amounted to about $18,000 outstanding at all times. Today, in 1 day, it is $50,000 for me as an individual dealer.

My supplier is even stricter on credit than they were 2 years ago, and at their shareholders' meeting in May, the president of the company talked about finding a way to pass on the cost of credit cards. In my neighborhood, that is going to be a tremendous burden on me, because at least two-thirds of my business is the company credit card.

Senator **Sarbanes**. Mr. Cannon, did you want to add to that?

Mr. **Cannon**. Just one other thing. You asked about sources of funds for small business. Just giving Mr. Rice's company as example with the exhibits that are attached to his presentation, he recites historically that the original funds he used to purchase the business were because of a loan that was guaranteed by the SBA and that made it affordable, if you will, so that the risk was compensated for by the guarantee. And it has permitted his business to grown from $1.5 million in gross sales in 1970 to almost $25 million this past year during which he took his company public.

But there is no question that, based upon my own experience independent of this, the Small Business Administration and direct loans from the Small Business Administration, when they are available, are the first source that a small business goes to, both to start its business and to expand its business. To the extent that that is curtailed and to the extent that a guarantee is not available, which results then in the need to go to a factor or other adjectives that are used to describe lenders who charge extraordinarily high interest, it is all reflected to the extent that a guarantee is available by the SBA or some other Government agency. It would reduce, in theory, and it historically has reduced the interest rate that the lender deemed appropriate to charge, because they had hedged a portion of the risk.

Senator SARBANES. The rates are raised on the premise of fighting inflation, but I'm concerned that the higher rates themselves contribute to the inflation that they are supposedly fighting.

In the case of small business, wouldn't it be fair to say that almost invariably the higher cost of money and credit which you are paying is passed on to your customers? It must be. What else can you do with it?

Mr. SEAGER. Small business, especially when we're competing with large corporations, it is very difficult to get the full price interest through, especially with the rate of inflation being so steep here in the last 2 years. So it's very difficult to pass it through, as far as price increases. So that is why we are seeing deteriorating profits and deteriorating net worths. It is a much more difficult situation for the small businessman to borrow on.

Senator SARBANES. That would then address these figures. The statistics on the increasing number of businesses that actually failed, I read at the outset, have almost doubled since 1978 and are at their highest level in the last decade. In other words, you are caught in a situation where, because of the competitive situation with large concerns, you are not able to pass on that cost fully.

Mr. SEAGER. That's right. In the long run, it would be inflationary, because of the elimination of the small businessman, as far as competition. There will become more and more monopoly with the large corporations.

Senator SARBANES. Let me ask you an either/or question. I know people like to have it both ways. A lot of tax cuts have been made, and I'm supportive of a number of those. On the other hand, it's arguable that the size of the tax package is now causing the Fed to pursue this policy.

Would you say that getting the interest rate and credit situation into some reasonable perspective is a most important priority? Would you trade off some tax concessions which obviously are advantageous to you, if it meant you could get the credit situation into a reasonable perspective?

Does that make sense in the view of small business?

Mr. SEAGER. It definitely would, because in the case of the small businessman, the tax incentives are not really that beneficial to him. Again, if the profits are deteriorating and again, describing the size of the small businessman, you're not talking how many dollars as far as tax incentives go, so the key to it is to be able to control the interest and to be able to have the availability of funds. Many decisions now by small businessmen are made on the day-to-day basis, based upon cash needs; then it is the bottom line.

So it would be anything that can help as far as lowering the day-to-day cost are much more critical to the small businessman than something that may be 1 year or 2 years out, as far as tax incentive. And again, taking a look at it on the overall scope as far as dollars go, it is much more critical to the small businessman as far as cash goes.

Senator SARBANES. I do want to underscore Mr. Cannon's point about the forms and the regulations, and so forth. I think it is very important. There have been some efforts made in the Congress to achieve some simplification, but obviously a large concern has an office to do its own internal work, but a small business does not have such an office, and you really are adding to their burden.

Mr. Grady, did you want to comment on that?

Mr. GRADY. Well, I tried to come prepared to answer that question, but my accountant has not had a chance to look at the proposed benefits to small business. I would take it, and have asked him as soon as he has a chance or when it is printed to take it on an individual basis, the two pieces of equipment that I would like to invest in. Will the tax benefit and a fast writeoff overcome the steep interest rate?

I don't think I will ever borrow again where my interest rides up and down, if I can find other money with a fixed interest rate. I may not be able to, but I would look at it on that basis. On an investment in capital equipment, does the new tax rate enable me to ignore the interest rate and will I be coming out with something that makes sense to me? And if it does, I'm the kind of guy who wants to make the investment. I want to expand. I want to modernize.

Senator SARBANES. Did you want to add anything, Mr. Cannon?

Mr. CANNON. Just to distinguish Mr. Rice's situation where he particularizes the situation with his own company and says because it is so heavily personnel and service-oriented, that the investment tax credit and some of the credits that have been provided in the Economic Recovery Act are of no benefit or an insignificant benefit to his type of industry.

Senator SARBANES. That's a good point. Obviously, it relates to the nature of one's business.

Mr. CANNON. He says the only one of the credits or incentives available that are going to help his business is the targeted job tax credits, but that has a 1983 phaseout deadline.

So he summarized the act and its impact on his business, saying "I only have one carrot in that patch, and that carrot has a self-destruct period of 1983." So he is very specific, and I think he has done a very thorough analysis of it as it impacts his business, which has been very successful.

Senator SARBANES. Very good. As I said, his statement will be included in the record in full.

Gentlemen, we thank you. You have been a very helpful and thoughful panel, and we appreciate your participation. I ought to add that the hearing record will be left open following the close of the hearing, so if people should wish to submit further material or information during a reasonable period time, probably a week or so after the hearing is concluded, that will be acceptable.

If we could now go to Jerry Stautberg of Jerry's Chevrolet. You've been very patient, and we appreciate your being here today. Please go ahead.

STATEMENT OF JERRY STAUTBERG, JERRY'S CHEVROLET, INC., BALTIMORE, MD.

Mr. STAUTBERG. Thank you. I've found that the automobile business isn't an island in itself after listening to this; but however, being in the automobile business for the last couple of years we have a good deal, and I've listened with interest all afternoon—and interest is a great expense to us and a great problem in our industry.

We have another shadow just around the corner that nobody seemed to allude to that has been a great problem. That has been inflation.

So I sit here with mixed emotions on how to handle those. We had the NADA draw up some statistics, and I have just a very brief statement here regarding the automobile business this year. During the first half of 1981 325 franchised new car dealers have closed their doors. The single greatest cause of dealer failure is the burden of floor-plan interest. That is our interest on inventory, if you will. The estimated average annual floor-plan interest per dealer was $13,046 in 1970. During 1980 floor-plan interest expense rose on an average to $78,947 per dealer.

This is, or course, due to the tremendous inflationary cost of the vehicles, too, because the cost per vehicle that we're financing had increased tremendously in that decade, more than six times the 1970 figure.

With the weighted average prime rate during 1981 running between 3 and 4 percent higher than 1980, the floor-plan interest expenses burden during 1981 has been even greater. Inventory levels on August 1 of 1981 set an all-time record for that date of $2.1 million new cars. At the current floor-plan interest rate of 21, financing this level of inventory for the 80-day supply, it represents cost the dealer body $784 million.

Dealer employment between 1979 and 1980 fell from 813,400,000 to 738,000. This figure does not include the unemployment which resulted from the closing of 1,650 dealerships during 1980. It is estimated that these dealer closings represent a direct loss of 44,550 jobs.

High interest rates also depress consumer demand for new vehicles. Sales of new vehicles during 1980 were the lowest they have been since 1961. With interest rates even higher in 1981 than they were in 1980, sales of new vehicles are even lower this year, down 2½ percent from last year.

The 34 percent increase from General Motors sales during the first 10 days of August in response to GM's 13.8 percent financing rate promotion is indicative of the consumer sensitivity to finance rates. And there is no question that since the 13.8 promotion was put in effect the last few days of July that our floor traffic and our sales have increased considerably in the last 30 days, and just this morning they announced an extension of that program through the 23d of September; however, the dealer pays a good portion of that.

Senator SARBANES. I was going to ask that question.

Mr. STAUTBERG. We pay dearly for it, and we have to increase our sales considerably to try to stay even, if you will, with the incomes that we had on sales prior to this campaign taking effect, but by the same token, we are moving inventory and, as we move inventory, we get off of interest expense with the high inventories that we have been carrying, we historically have paid to GMAC three-fourths of 1 percent over the prime to finance our inventories and that has just been raised effective tomorrow to 1 percent, rather than three-fourths percent. And at 21-plus percent it is very difficult to pass that through to the consumer. So therefore, that has a great effect, obviously, on the bottom line operations.

Senator SARBANES. What was the financing rate you were giving the consumer before the GMAC put in this program?

Mr. STAUTBERG. Depending upon credit background, Senator, it would be in the area of 17 percent on new cars. On used it runs higher than that. Here again, used would depend upon the model year, how recent, and it would vary, I would say, from 18 to 19 up to 21 percent.

Interest, of course, is a tremendous problem to us, in that it limits the market, the ability of the buyer to buy. The disposable dollars that they had at their disposal in the last few years has dwindled considerably. Together with the inflation and the interest rates that we have to pass through—I keep referring to the inflation, because our increase in the price of product has been so significant in the last few years, that we watched 6 and 7 and 8 and 9 percent increases come at one crack, and to the point where we look at the average cost of a GM automoble in 1982 is going to be some odd $11,000.

Now that's taking the entire spectrum from Cadillac to Chevrolet. But a very significant increase, and, of course, with all of these increases, and fewer automobiles and trucks being sold, that again has a direct relation on employment and not only unemployment in manufacturing, but employment on the local scene with the dealers, the number of people that we need to operate our places of business.

We, in order to survive through these periods, have had to shrink our operations and our expenses and, obviously, when you go through one of these periods, personnel, unfortunately, are always affected. But it is fewer people working for us directly and fewer people for our suppliers and fewer people for, obviously, the manufacturers and their suppliers. And therefore, fewer people to buy those products.

And we feel that continually, and it also limits the stock that we can handle with the high interest rates, and we have fewer units available, more often than that. You're going to sell fewer, so it is fewer jobs again, because of lesser inventory, which is all we are able to carry, quite frankly.

The floor plan, as I mentioned, is 21½ percent. And in order to cope with that, dealer after dealer has been forced to reduce his inventory significantly. Now the manufacturers have come with various plans, if you will, trying to make it somewhat easier for the dealer to stock inventory, so that they can keep their assembly plants. But here again, it is all on the burden of the consumer, because those costs are passed directly through in the marketplace in pricing. And here again, the consumer is the one who finally is asked to pay the bill. And because of prices, we again hurt our ability to do business. Our monthly payments on automobiles today are very similar to what the gentlemen in the housing industry were referring to on housing payments a couple of years back.

So when you take the housing cost, as well as the automobile cost, from the average budget, it puts a heck of a dent into it.

I mentioned small business versus big business through the interest, and invariably the small guy seems to get hurt more in periods such as this, and certainly, the automobile business and the building business and savings and loan industry have been some areas, I think, who have shouldered this portion of the burden through the present crisis we are going through.

Our business, both from a manufacturing end and a retail end certainly has been a very viable business. It has been a heck of a good contributor over the years to the economy, and we think can and will be again. There have been statistics recently, as recently as a year or two ago, where one in six people employed in this country, either directly or indirectly, were employed as a result of the automobile business. And we feel that we are vital, and we have got to find a way to get through this period and remain viable so that we are here to do a job.

Since January 1, 1979, through July of this year, there has been 2,600 new car automobile dealers who have gone out of business, who have closed their doors, and if we don't get a handle on this interest situation, and I will say I. & I. interest and inflation together, we are going to have a heck of a lot more of them pass out of the picture with the track we are on, because you can handle it for just so long and one of two things happen, either you are unable to stay in, or it gets to a point that it just isn't worth it, and you try to free up your capital and just get out of that business and invest it and forget about it.

We also have a situation right now from a competitive standpoint, interestwise, where in order for us to sell our installment contracts, we are almost confined to the manufacturer's captives, if you will, such as GMAC and Ford Motor Credit, et cetera. Nobody—I say nobody, many of the banks are not interested in the retail paper today, and they are able to invest that money more advantageously in other sources without being concerned with buying the dealers' contracts. This again limits credit, and we don't have competition.

The finance companies do become more selective, obviously, and here again, the consumer is the one who ultimately is asked to come up with more downpayment or not even have the ability to buy, if you will. They won't accept them, whereas a few years ago there would be no question that they would have been able to buy their car and go on.

So these have all taken their toll on our sales, our cash-flow problems, and our business can become severe when a dealer is looking at these tremendous interest costs that have to be paid monthly, irregardless of what happened on his sales front or business scene through the prior month. And these huge interest bills, that they are just totally unprecedented in our business, are a considerable factor in the ability of dealers to survive. And it is a game of survival in many respects. The fact that General Motors and Ford have entered into some financing plans of one nature or another to finance these inventories, again, is unprecedented until a year ago. They have always maintained that the dealer is an independent businessman and it is his obligation to arrange for his own financing, which I frankly subscribe to.

But the thing has become critical to the point that they had to do something.

Senator SARBANES. Am I correct that the overwhelming percentage of your sales are on credit?

Mr. STAUTBERG. You are correct when you say "overwhelming," Senator. We look at them in two ways in our business. We look at the paper that we actually place directly out of our business, which ordinarily would run 50 to 60 percent, that we control. And then you have the customer who has their own sources of financing—be it a credit union, or direct loan, or whatever. And when we get all through, it is somewhere in the 85 to 90 percent factor.

Right now, with this 13.8 percent rate that GM is offering, we find that we are controlling about 85 to 90 percent of our sales. So I think that would substantiate that pretty well. And when I say "controlling it," we are financing that many of the sales.

Senator SARBANES. Instead of 50 to 60 percent, which would have been the previous pattern. Is that correct?

Mr. STAUTBERG. Yes.

Senator SARBANES. That is the next question I wanted to ask. We talked with the small business panel about how, both at the one end and at the other, they were being pressured in terms of where the money flows and who holds it during these high interest periods.

Has that brought a change in the practices now in the auto business, as between you and the manufacturers, for example?

Mr. STAUTBERG. Not really. Their problem is our problem, obviously on a much grander scale. But in order for the manufacturer to succeed, they have got to ultimately retail these products in the marketplace. And they really have—as I just pointed out, they have done some things that they have refused to do up until this past year, in order to try to make it more viable for the dealer.

I can't really say that we have been pressured or hammered into a corner. Our receivables, or returns, our payments—all of these things, in many respects, have been lessened somewhat, in some small ways, by things that they have done.

Senator SARBANES. In other words, virtually every purchaser who is financing his car is making use of this special arrangement which the manufacturer has put forward?

Mr. STAUTBERG. That is correct.

Senator **Sarbanes**. Do you think that the interest rate or the carrying charge, in effect, on the automobile is the essential determining factor to your purchasers?

How is that interrelated with the price? Of what important is the interest rate?

Mr. **Stautberg**. The ability to buy, the ability to afford, and the mere fact that, after all, the consumer is readily aware of the prime rate—I think he gets enough publicity from the 20- and 21-percent figures, as I have just pointed out to you earlier.

Historically, we did not run as high as the prime rate, even prior to this special promotion. But when you come with a special incentive, I believe it brings people out, knowing that there is an incentive there for them and they can take advantage of it. So they come in and find out what these charges are, and they can compare what they would be and what they are, and make a decision as to whether or not they are going to go ahead and buy at this time.

I believe—to answer your question—it gets down to what can you afford, and how does it fit into your monthly budget, and how much is that payment.

Senator **Sarbanes**. You talked about a number of auto dealerships that have gone out of business.

How would you characterize them, in terms of the efficiency and effectiveness of their operations?

Are some pretty good people going by the board, or is it hitting primarily marginal people?

Mr. **Stautberg**. There are two areas. You've got those who have said they are just going to fold the tent; and there are no bankruptcies or anything of that nature. They just take their money, and go elsewhere, and get out of the business because the return isn't there. And then you do have some marginal and inefficient operators who, in time such as this, it will really catch them rather quickly. And in a few instances, some operators who I can think of who, in good times, were operating reasonably successfully, but were highly leveraged; they have been caught in the squeeze.

I can think of a dealer who is involved in huge fleet sales across the country. Because of the money cost and the rollover of those dollars being delayed—the big corporations know how to play that game pretty well, too, as far as paying you. And I think that there are a few that have been put up against the wall, but they are in the minority.

Senator **Sarbanes**. Well, this has been very helpful, and we appreciate your testimony and your patience, Mr. Stautberg.

Mr. **Stautberg**. Thank you, Senator Sarbanes.

Senator **Sarbanes**. Thank you, again.

Our final witness will be Jim Lucass, who will be speaking for the county executive. Jim is the director of the Economic Development Commission of Baltimore County.

Mr. Lucass, we are pleased to have you here.

STATEMENT OF JAMES D. LUCASS, JR., DIRECTOR, BALTIMORE COUNTY ECONOMIC DEVELOPMENT COMMISSION, TOWSON, MD.

Mr. LUCASS. Thank you, Senator, we especially appreciate the opportunity to appear before your subcommittee, to speak about the effects of continuing, unprecedented high interest rates on Maryland communities. We would especially like to commend you, Senator Sarbanes, for conducting one of your hearings here in Towson, the county seat of Baltimore County, because we in this county have the largest industrial tax base of any jurisdiction in any county in the State.

First, let me give the subcommittee a short report on the Baltimore County economy since 1979. County industrial and business firms have undertaken growth and expansion, in the past 2½ years, of over $260 million. The rate of growth here has been 200 percent greater than any other period in our history.

At the same time, we have dominated nonresidential growth here in the Baltimore region. We have accounted for over 37 percent of the Baltimore SMSA's growth, eclipsing even the efforts of the charm city of Baltimore, whose renaissance has received well deserved national and international acclaim.

This growth and expansion has most certainly been even more fortified by three significant announcements of new projects. Bethlehem Steel, the largest private employer in the State, has announced plans for $300 million investment in Sparrows Point, to refurbish plate and hot strip mills, along with construction of a continuous caster. The addition of a continuous steel caster, along with the existing largest blast furnace in the Western Hemisphere, should mean that, by the mid-1980's, Sparrows Point will be one of the most modern and efficient steel-producing facilities in the world. This means more business, as we undertake the rebuilding of a 600-ship U.S. Navy in the next decade.

Martin Marietta's Aerospace Division has recently announced a major multimillion dollar Navy surface ship vertical missile launching system contract that will mean the moving of 200 top engineers up from Florida, plus the hiring of many hundreds more production workers in its Middle River facility.

AAI—Aircraft Armaments, Inc.—in Cockeysville has recently received an $80 million subcontract to refurbish the M-48 tank weapons systems for the Army. AAI has also decided to undertake the construction of almost 1 million square feet of industrial and office spaced over the next 5 years, in order to meet the demand for weapons and other defense-related systems.

Industrial and business growth requires capital. The new tax bill passed recently by Congress will go a long way toward helping generate this capital, through accelerated cost recovery and swapping of tax credits as part of leasing arrangements. Tax policy alone, however, will not provide sufficient capital to meet the demands for the next decade.

The unprecedented high interest rates are particularly damaging to the small businesses in this country, as you heard just a few moments ago. Recent studies by David Birch at MIT confirm that, in the seventies, over two-thirds of the new jobs created in this country were in firms employing less than 20 persons. The major reason given for the failure of most small businesses is the lack of sufficient capital.

Small businesses have responded to high interest rates by turning to various Government-assisted programs. Such vehicles as the UDAG grant program, the block grant revolving loan funds, Small Business Administration—both 502 and 503 programs—our own Maryland industrial commercial revitalization fund, and industrial revenue bonds have grown, from almost nothing 5 years ago, to become significant in capital markets.

Industrial revenue bonds have recently been singled out as a problem area because of the unfortunate abuse by a few overagressive jurisdictions. It is our belief, however, that industrial revenue bonds are the major Government-assisted source of capital in this country today. Fully 25 percent of Baltimore County's industrial and business growth in 1979 and 1980 was financed using industrial revenue bonds. With over $53 million in financings, we know over 2,700 jobs were created by industrial revenue bonds—most of them for small businesses.

However, even industrial revenue bonds, where interest paid to the lender is exempt from Federal income tax, are almost prohibitive today. In the past 9 months, most Maryland lenders have been quoting 65 percent to 75 percent of prime rate as interest cost for industrial revenue bonds. With the prime rate near 20 percent, this means Federal tax-exempt financing is about 14 to 15 percent.

It seems to us that the President and Congress, along with the Federal Reserve, must jointly address the problem of high interest rates. The perception of most business persons we talk to—even most working people—is that the Federal Government is the major source of high interest rates because of deficit spending and loan guarantee programs.

A recent issue of Forbes magazine stated that the Federal Government now is the largest single source of demand for the U.S. credit market, accounting for 38 percent of total, versus only 16 percent a decade ago. For example, in 1982, various Federal agencies—such as the Federal Credit Administration, Federal Home Loan Bank, and Federal Home Loan Mortgage Corporation—plan to raise or refinance federally sanctioned loan guarantee programs of $105 billion.

Deficit spending has become a standard operating procedure by the Federal Government since the Vietnam war. Deficit spending is exacerbated by high interest rates because even the U.S. Treasury is paying 15 percent for money. Estimates are that a 1-percent increase in interest rates adds $7 billion to the Federal deficit.

How do we stop high interest rates?

The emphasis on that question is "we."

A place to start is the kind of hearings this subcommittee is conducting, to learn what businesses and working people feel about high interest rates. And a national debate about the long-term effects of high interest rates is now underway in the media—in both the written press, as well as public media. The solution to the high interest rate problem cannot follow until the country, Congress, and the President recognize the problem.

All of us have to give up the idea of looking to Washington to solve our problems. That means less defense weapons than we'd like to have. Less money for social programs that are desperately needed in some communities. Less money for roads and other things Government wants. Less loan guarantee and federally sponsored programs. Yes, even maybe tightening the rules for industrial revenue bonds, so that there are not the abuses that we've heard about.

All of us in this country—business, Government, and labor—must be willing to do with less, if we are going to be better off. Without the dream of raising a family for a better life, there is no America. Ours is the greatest economy in the world. Without a solution in the near future to high interest rates, we may have to forever say goodbye to America as we have known it since World War II.

We hope this subcommittee will act decisively to continue to cut Government deficit spending and loan guarantee programs.

Thank you, Mr. Chairman.

Senator **SARBANES**. Thank you very much.

Mr. Lucass, do you know when was the last time the county floated a local bond issue, and what interest rate it paid? Do you have that information?

Mr. **LUCASS**. If memory serves me right, Mr. Chairman, for the first time, we had to postpone a general obligation issue late this last fall and early winter, and did in the springtime—as I recall, something like March—sell a $40 million general obligation bond issue supported by the taxes of county citizens, for something like 8.75 percent, tax-exempt. We happened to catch the market at a very good period. We, as you know, are a AAA-rated county, one of the few jurisdictions so rated by Standard & Poors and Moody's on Wall Street. Today, we would have to pay a good more than that—probably 10 percent, or in that vicinity—just for those bonds.

Senator **SARBANES**. And what about on your industrial revenue bonds?

Mr. **LUCASS**. They typically are running in the vicinity of 14 to 15 percent. Here, I would say that the biggest change we've seen in the last 9 months is that there is no flat-rate mortgage money available to businesses, even for industrial revenue bonds.

In other words, when the borrower is borrowing money, he is doing so in relationship to the prime rate. It is floating, very much like businesses, like the automobile dealerships. What that means is that the borrower is oftentimes at the whim and mercy of what takes place, in terms of both fiscal and monetary policy, in the national scene.

Up until 9 months ago, we were seeing a number of financial institutions that were lending long-term money—10 years and longer—at flat rates.

Senator **SARBANES**. When did that practice stop?

Mr. **LUCASS**. I would say, essentially around the summer of last year. I think it is fairly coincident, in relationship to the activities of the municipal bond market, which undertook some dramatic changes at that time, which are fairly coincident, I believe, with some policies, some adjustments in policies, on interest rates by the Federal Reserve. I think it is fairly coincident.

Essentially, our lenders are commercial banks that don't like long-term mortgage money, anyway. And they felt the only way they could shelter themselves from what appeared to be changes in rules, with regard to interest rates, was to make industrial revenue bonds in relationship to prime rate.

Senator **Sarbanes**. Thank you very much for you very helpful statement. We appreciate it.

Mr. **Lucass**. Thank you, Senator.

Senator **Sarbanes**. That concludes our hearing for today.

We thank everyone for attending; the subcommittee is recessed.

[Whereupon, at 4:30 p.m., the subcommittee recessed, to reconvene at 9:50 a.m., Tuesday, September 1, 1981.]

EFFECTS OF HIGH INTEREST RATES ON MARYLAND COMMUNITIES

TUESDAY, SEPTEMBER 1, 1981

Congress of the United States,
Subcommittee on Investment, Jobs, and Prices
of the Joint Economic Committee,
Washington, D.C.

The subcommittee met, pursuant to recess, at 9:50 a.m., in the hearing room of the Legislative Services Building, 90 State Circle, Annapolis, Md., Hon. Paul S. Sarbanes (member of the subcommittee) presiding:

Present: Senator Sarbanes.

Also present: James K. Galbraith, executive director; William R. Buechner, professional staff member; and Betty Maddox, assistant director for administration.

Opening Statement of Senator Sarbanes, Presiding

Senator Sarbanes. The subcommittee will come to order.

This is the second day of hearings that the Subcommittee on Investment, Jobs, and Prices of the Joint Economic Committee is conducting to examine and document the effects of high-interest rates on Maryland communities and citizens.

Yesterday, we heard graphic examples from a wide range of business and local leaders concerning how high interest rates have hurt the local economy in Baltimore County. Today, the Joint Economic Committee moves to our State capital this morning and to Wye Mills this afternoon to review the impact of high interest rates on local communities in Anne Arundel County and Eastern Shore.

In six separate hearings this week, we will hear from more than 80 witnesses about the severe challenge of high interest rates—a challenge which these witnesses know best since they face it daily in their own economic activities.

It is not exaggeration to say that the problems created by continuing high interest rates are approaching crisis proportions. The situation this year, with the prime rate remaining over 17.5 percent, is unparalleled.

In the last 12 months, the prime has been as high as 21.5 percent, and today it remains at 20.5 percent. The mortgage rate at many financial institutions is over 17 percent, the highest it has ever been.

The interest rate on tax-free municipal bonds is now over 11 percent, twice what local governments had to pay only 4 years ago.

These rates have created grave obstacles to the operations of many established and productive enterprises, particularly in those sectors of the economy which depend upon a line of credit. The damage thus far is serious; and, if conditions are not soon improved, will be irreparable. Enterprises which have been an important asset to their respective communities, an important economic resource, will be lost.

The burden of high interest rates has become a major financial problem for small businesses. Auto dealers and other sellers of consumer durables have been particularly hit.

For the first time in the history of a quarterly survey by the National Federation of Independent Business, small businesses rank interest rates and financing as the single most important problem facing them.

The survey, which was released last week, says:

"The currently high rates of interest are making a bad situation unbearable for many small firms."

Last year, almost 12,000 businesses failed nationwide, the highest figures in more than a decade and almost double the number of failures in 1978 when interest rates were only half their current level.

The situation is particularly critical in the homebuilding industry. Housing starts last month stood at an annual adjusted rate of just over 1 million, down 17 percent from the already-reduced pace of a year ago and only half the 2 million starts needed to meet nationwide demand.

Construction-related business is similarly depressed. Unemployment in the construction industry is running at 15 percent, more than twice the industrial average. Home sales have fallen dramatically, down in Maryland as much as one-third from the levels of 2 years ago.

Financial institutions, particularly savings and loan associations, which have done so much to make homeownership a reality, face unprecedented pressure.

High interest rates also have very serious implications for the finances of State and local governments. As a Sunday's New York Times article commented:

> These are dark days for State and local treasuries * * *. Prices of municipal bonds have been sliding all year and fell to a historic low last week. At the same time, the interest rates that governments have to pay on their new bonds have reached historic highs.

This is an especially serious blow at a time when State and local jurisdictions must look forward to sharp reductions in financial support from the Federal Government.

The Federal Reserve Bank in Richmond reports that Maryland farmers are now paying the highest interest rate they have ever had to pay for bank loans, with many farmers paying 2 percentage points above the current prime rate.

As a result, farmers across the State, as elsewhere in the Nation, have been postponing or abandoning productive investments which would make them more efficient and effective producers. And we will be hearing testimony this afternoon, in Wye Mills, directed to that very point.

The purpose of these hearings is to document across the State, with testimony from those directly affected, the conditions to which these statistics attest.

Over the past 18 months, the Joint Economic Committee, created by the Employment Act of 1946 to provide Congress with economic information and advice, has held a number of hearings on the interest rate question, and will undoubtedly return to this matter when the full committee in the fall begins its examination of the impact of the recently enacted economic program.

It is my hope and expectation that the record of the Maryland experience established by these subcommittee hearings will make an important contribution to the full committee's work and to the response which policymakers must undertake to remedy this pressing economic situation.

This morning we are very honored to have as our leadoff witness the Governor of the State of Maryland, the Honorable Harry Hughes.

Governor, we are very pleased to have you before the subcommittee, and we look forward to your testimony.

STATEMENT OF HON. HARRY HUGHES, GOVERNOR, STATE OF MARYLAND

Governor HUGHES. Thank you, Senator.

I have submitted a prepared statement, which I am not going to read, with your permission.

Senator SARBANES. Your prepared statement will be included in the record in its entirety, Governor.

Governor HUGHES. This generally expresses concern about the high interest rates, but does point out that, in spite of that, Maryland, because of its diversification in industry and business, is rather optimistic about the growth we are experiencing here in the industrial and business community, citing some figures over the last couple of years of over $2 billion in investment.

So I would like just to give, in addition to that, some of my own personal observations. You will be hearing from other State officials in special areas of the more specific effects of high interest rates.

I happen to believe that the high cost of money and the high interest rates is probably the most serious problem that we have in this country as far as our economy is concerned.

You've already cited the litany of areas that have been affected. And that is true in Maryland, as well as elsewhere.

The housing market, as you know, has fallen off almost a third in the last 2 years. We do have a State program, and the reason for the State program is to try to make available to low-income—low- to middle-income citizens of Maryland, mortgages at a rate they can afford. That program is just overrun with applicants.

We recently received applications and did it by the drawing lots. Prior to that, if we didn't do that way, we had lines all the way around the block. And I think it points out that there is a terrible need among the citizens of Maryland for reasonable interest rates on mortgages so that they can purchase homes.

I was talking to someone yesterday, as a matter of fact, who said that in Columbia if someone is selling their home and they happen to have a mortgage on it that has about a 9-percent interest rate and that mortgage is assumable, that that fact alone will add about $10,000 to the sales price of the home, which I think is a specific example of the effect of the high interest rates.

Another effect is the proliferation of revenue bonds around the country, which is becoming of some concern. I know it is to the Congress and to others, too. And I think this has to be a result of the high cost of money.

If you can offer to an industry that wants to expand or to locate in this State, for example, some of their financing through revenue bonds at an interest rate of 11 or 12 percent, or 10 percent, whatever it might be, that is a very attractive tool that is being used nationwide, throughout the country, as a result of the high cost of money in the private market. And the concern there, obviously, is that the proliferation of the revenue bonds has had an adverse effect on general obligation bonds.

You mentioned that the interest rate on general obligation bonds has increased significantly. Our last issue, in May or June, was about 9.2 percent. Less than a year-and-a-half before that, our bonds sold for 6.1 percent, which we thought was very high at that time.

I've just heard today that the State of Washington sold AAA bonds yesterday—I think for water and sewage treatment plants—and the price, the interest cost there was 15 percent on a AAA bond. I haven't verified this, but I was just made aware of that.

So, the high cost of money is certainly having an adverse effect on municipal bonds, State bonds, and the tax-free bonds. And I am sure—I don't have any figures for this, but I am positive that the most serious effect on businesses is the high cost of money for small businesses and farmers.

Sure, it affects large business, but they are able to cope with it better than the small businessman and the farmer. And I am sure the 12,000 businesses that failed last year—a very significant portion of them were small businesses rather than large businesses.

So far as large business is concerned, I think we probably have an example, just yesterday, of the effect of high interest, where General Motors has delayed their plans to expand their plant in Baltimore, something that the city and the State have very much concern about. It employs a couple of thousand people. We were very elated when they made their decision to stay here, and more elated when they made their decision to expand in Baltimore. Now, they are delaying that because of the fall-off in the sales of automobiles. Again, that has to be a result of the high cost of money.

In our own State, as elsewhere, in the last couple of years, there has been a tremendous fall-off or closing of automobile dealerships.

So, in the area of automobiles and other items that people need, appliances, where financing is necessary, it certainly does have an adverse effect. And it has a rippling effect throughout our economy.

So, in sum, I repeat what I said in my opening remarks, that I think the high cost of money is the most important problem that we have in our economy in this State. It is a national problem. And if it is going to be solved, it has to be solved at the national level.

Obviously, the State of Maryland can't solve that problem, nor can any other individual State.

Of course, one of the reasons for the increase in the cost of municipal bond interest is the tremendous borrowing that the Federal Government is doing in the market. I understand the Federal Government borrowed something like $40 billion recently in the market. That dries it up pretty well. And with that, you can understand maybe why the State of Washington had to pay something like 15 percent.

Those are just some personal observations, Senator, that I had. And I would hope that somehow—and I don't have the answer, but I would hope that somehow, at the national level, that this problem can be solved because, again, I think it is a most serious problem and contributes to inflation.

And probably there is a crisis in confidence among people and they become pessimistic about doing what everybody likes to do, and that is look forward to buying their own home. They haven't much to look forward to in that regard.

So, the rippling effect is very damaging to our entire economy.

So, I'd be glad to respond to any questions, Senator, if you might have any.

Thank you, Senator.

Senator **Sarbanes**. Governor, thank you very much, both for your comments and for your very thoughtful prepared statement.

[The prepared statement of Governor Hughes follows:]

PREPARED STATEMENT OF HON. HARRY HUGHES

I am grateful for this opportunity to discuss with you the effects of current interest rates on the economy of Maryland.

Your concern, as will be detailed by Secretary Cawley and Commissioner Fell in their subsequent remarks, is shared by us. It is one which has been developing since the inception of the trend toward the use of higher interest rates and the tightening of the money supply as a means of curbing inflation.

This Subcommittee on Investment, Jobs, and Prices is to be commended for its efforts to determine whether we are proceeding in the proper direction and, if so, whether we are proceeding at the most effective pace. We are aware that, given the potential benefits of such a course, too slow a pace could prevent us from achieving the desirable goal. That goal, of course, is the stemming of inflation which erodes the earning power of working Americans and encourages speculative investments instead of business and industrial expansion which generates that earning power.

By the same token, too rapid a pace could be counter-productive. It could channel so much potential investment capital into other areas, thereby retarding business and industrial expansion. It could also compel small retailers and other consumer-oriented businesspersons to compete with high-interest-bearing investments for their own supply of capital to stay afloat. This often necessarily results in an additional cost of doing business, with the transfer of that additional cost to the consumer.

Underlying these basic observations is a point which we in Maryland are eager to make: The economy of our State is of such a tough fibre that, to a greater degree than that of most other States, it is able to withstand the debilitating effects of general economic trends. One reason for this is the great variety of our business and industry, ranging from the production of basic goods like steel to the rugged individualism of our generations-old Chesapeake Bay seafood-harvesting enterprises. Combined with our recently reinvigorated economic development program, these have enabled us not only to weather nationwide recessions, but actually to make great gains in the attraction of new enterprises to our State and the expansion of existing ones.

To illustrate this, we need only to consult a few figures: Within the first two years of my administration, new capital investment in Maryland totaled more than $2 billion. For each of these years, this is more than four times the figure for the last preceding year—1978. During that time, we have added 10,000 new jobs for Maryland workers, compared with the 4[illegible],000 manufacturing jobs which this State lost in 1972 through 1977. In addition, this new capital investment is expected to generate another 30,000 jobs within the next five to seven years. And our continuing efforts to attract new business and to encourage the expansion of existing business indicate that there's more to come.

But our pride in these developments and our confidence in the future cannot blind us to the realization that greater stimulation of investment in production capacity could mean even greater progress. There is no disguising or denying the signs that such stimulation could be greater. Just two days ago we read news accounts of problems besetting the real estate business: Nationwide home sales last July dropped to their lowest level in five years. In the Greater Baltimore Area, despite a general resurgence and revitalization of that great community, home sales for July were down 14% from the previous July, which in turn was down about 18% from July, 1979. And only yesterday we learned about the postponement of one phase of the General Motors plant expansion in Baltimore because of market conditions.

I repeat that we in Maryland are fortunate to be able to weather downward economic trends, and I am confident that our progress will continue through this one. But, with the stimulation of still more capital investment and with interest rates which curb inflation without restricting business growth, that progress could be even greater.

Thank you.

Senator SARBANES. Governor, I just want to pick up on your last point, about people regarding the future with pessimism. We heard some testimony yesterday from the small business people and homebuilders and realtors that really reflected a growing embitterment, in the sense that many people who have conducted very efficient productive enterprises over the years now feel that they simply are being put up against the wall through absolutely no fault of their own. These are not marginal operators who have been inefficient, or have failed to perform a significant economic service. These are people who have really been the mainstay of the community and its economic activity, and they simply cannot withstand these high rates.

I was interested in your comment that the interest rate paid by the State on its highly rated bonds, has gone from 6.1 percent to 9.2 percent in 1½ years. In other words, that is a 50-percent increase.

Governor HUGHES. The 6.1 percent, as I recall, was around January or February of 1980. And the 9.2 was in June of this past year. And we are holding our breath now, because we are going to the market in October for about $120 million in bonds. And if Maryland does have as high, a AAA, rating as you can get, that is an extreme increase and an extreme cost to the taxpayers. Every 1 percent is a lot of money over a period of 15 years.

Senator SARBANES. Do you recall what the State's interest payment would come out to?

Governor HUGHES. No, I couldn't give you that figure.

Our annual interest cost on our general obligation bonds?

Senator SARBANES. Yes.

Governor HUGHES. No, I really don't have that figure. But for every dollar we borrow, it is now about $1.80 or so that we have to pay back. It used to be significantly less than that—$1.50 less than 2 years ago.

Senator SARBANES. So, in effect, the high interest rates increase your budgetary difficulties?

Governor HUGHES. Yes.

And in Maryland, the property tax, the State property tax, is dedicated for that purpose. We do appropriate, out of general funds, a certain amount of money, in an effort to hold down the State property tax. But the property tax is pledged for that purpose, and we are required to levy property tax in whatever amount is necessary in order to meet that debt amortization.

We did have to increase it slightly this past year, but we do appropriate, out of general funds, millions of dollars to hold down the property tax. I can get you the figure of what our annual interest costs are if necessary.

Senator SARBANES. I think the conclusion, which is very important, is that the high interest rates which are being advanced as a means of controlling inflation themselves become a contributing factor to the inflation in a number of different respects.

We have heard the point made that an assumable mortgage at a lower rate, is reflected in a premium on the cost of the house. Therefore, you have higher housing costs right there. You have the higher carrying charges on homes and durables because of the higher cost of money—in other words, the interest cost. And now we see it reflected in the State's budget. The higher interest charges you have to pay are reflected in an increased property tax, which itself is fed into the cost of living.

So these high interest rates, ostensibly put in place to check inflation in effect, are contributing to the inflation and pushing it forward.

Governor HUGHES. Another factor which enters into the municipal bond picture is—as I understand the Federal tax cut program—the maximum tax rate on unearned income has been lowered from 70 to 50 percent. I believe I'm correct.

There is great concern that this is going to have an adverse effect on municipal, State, tax-free bonds—on investment in the private sector.

Whatever the investment might be that pays 18 percent or so is going to be a lot more attractive to someone who only has to pay 50 percent tax on it than when they had to pay 70 percent.

So, that is going to tend to make municipal bonds less attractive than they were in the past, which, again, is going to probably result in an increase in interest rates on municipal bonds.

Senator SARBANES. Has the State been forced to adjust significantly its capital budget program because of the high interest rates? Or has that not yet happened?

Governor HUGHES. Well, the answer, I guess, is yes and no. The State, a few years ago, set up a Debt Affordability Committee to, each year, recommend how much new debt the State should create. That was brought about at that time more because of the growing debt of the State—again, because of the school construction program that the State had assumed.

So, since that State committee has been in operation, we have tried—and I think with a great degree of success—to stay within the debt limit, the new debt limit recommended each year by this committee. It now takes on a more significant importance because of the high interest rates.

I have recently set up an in-house committee to look at our capital program—because of the high cost of money—to see if maybe we should not defer some of that which has already been authorized and to try to analyze such things as is it better to wait a couple of years, even though you know inflation is increasing and the cost of construction.

But that might be less than the interest costs if they are as high as we fear that they might be, so that we can make some judgment that, yes, it makes more sense from the taxpayers' standpoint to delay our capital program rather than move ahead with it and pay the high interest cost, even though we know that there is going to be inflation. But the interest costs maybe would more than offset the increase in inflation.

Senator SARBANES. Are local governments coming more frequently to the State and saying "The high cost of money is precluding us from moving forward with some very important projects, and therefore we need to turn to the State for assistance of one sort or another?" Are you encountering that from local officials?

Governor HUGHES. I don't think we have had too much of that. You must remember that the State took over the local government's biggest debt program, which was school construction. So, with the exception of water, sewer, and those kinds of things, and some Baltimore city bonds, most of the tax-exempt bonds in the States are State bonds today.

So, I can't recall that we have had that kind of local government effort to assist them, although we do have programs that are capital-oriented and do assist the local governments—local jails, for example, the State pays 50 percent of the cost.

But I can't recall having any knowledge of any concerted efforts.

Senator SARBANES. The State government's budget and its fiscal position, obviously, depend on the State's economy. As you point out, we are fortunate to have a very diversified economy, which has been one of our main economic strengths.

But as you look ahead with these continuing high interest rates in mind, are you fearful of the slowdown or maybe even the recession approaching a depression in certain sectors, which will have a marked impact on the State revenues and therefore create a further budgetary difficulty for you—one that has already, of course, been created by reductions in Federal assistance for State and local governments?

Governor HUGHES. I am fearful of that.

One area where there is a direct effect on State revenues is in the house. For every home that is built, the State gets anywhere from $2,000 to $4,000 or so in sales tax. So, when homebuilding is off, our sales tax reflects that decrease.

Recently, the sales and income tax were looking better in the State of Maryland, better over a bad situation that occurred a year or so ago. But I am fearful about the long term trend. I hope this is setting a pattern from long-term, but I don't really know.

Senator SARBANES. The same thing would happen with auto sales, too.

Governor HUGHES. Auto sales would fall off. The effects there are the entitling tax, which is a large source of revenue for the Department of Transportation.

So, when—and in appliances and durables, as you say, they are subject to sales tax.

So, whenever those things decline, just as night follows day, it has an effect on our tax revenues at the State level, all of which is affected by high interest costs.

Senator SARBANES. Governor, thank you very much for your very helpful testimony. We appreciate your appearing before the committee.

Governor HUGHES. Thank you.

Senator SARBANES. Our next witness will be Hursey Porter, representing the realtors. Hursey is president of the Maryland Realtors. He comes from Salisbury, which is my home town.

We're very pleased to have you here before the committee. Mr. Porter, if you will go ahead with your statement, we would be happy to receive it.

STATEMENT OF R. HURSEY PORTER, JR., PORTER-DENNIS, INC., REALTORS, SALISBURY, MD.

Mr. PORTER. Thank you, Senator. I want to thank you and the subcommittee for taking interest in this very critical problem that we're experiencing today of high interest rates.

I am wearing three hats today, one of which, as you have already alluded to, is the president of the Maryland Association of Realtors, second as a small businessman in Salisbury, Md., and third is that of being a real estate broker.

Many of my remarks today are not something you haven't already heard but you will certainly hear a lot of over the course of the hearings that are scheduled in the future. In my remarks, I hope I will reflect the effect that the interest rates are having on the home buying and selling public—not just the real estate industry.

The severity of the unprecedented high interest rates we have experienced over the past 2 or 3 months have practically devastated much of the housing industry already, and we feel in the real estate industry that it is now reaching a crisis stage as it may affect the entire economy.

As we all know, housing is one of the first areas to be hit by excessively high rates because of the long-term credit requirements of the buying public. Unfortunately, today 90 percent of our citizenry cannot afford to buy a home. I venture to say that 50 percent cannot afford to refinance the homes that they are presently living in because of the high interest rates—not so much because of the price of housing but because of the cost of financing that housing.

As I stated before, I am an active broker in Salisbury, Md., and I would like to give you some statistics as to what has happened to housing in our area. In Wicomico County, Md., particularly, sales are off 30 percent for the year this year.

Senator, last year the sales were off 25 percent. If we couple last year's off-sales and this year's off-sales, we have a combined total of over 50 percent off in sales from 1979. Today the figures show that housing sales in Wicomico County, Md., are off 43 percent—this August versus last August—which is an incredibly low figure.

The reason for it is because last year we saw a reduction in rates during the month of July. Housing picked up. In many cases, we sold as many homes in the middle quarter of last year when the rates were down as we had sold during the entire year. We are unfortunately not enjoying or experiencing that increase this year, thus representing a 43-percent decline.

The Governor alluded a few minutes ago to a Maryland program, which is the Maryland home financing program, which he very clearly stated that there was insufficient funds to cover the demand. In our office alone, we submitted seven contracts for sale, pending that type of financing, which was 10 percent financing. We had one individual selected out of seven. There were 14 turned in from Wicomico County.

I cannot stress to you the disappointment and the dismay on the faces of those individuals who had hoped to buy a home and were taking their chance on being drawn from that lot.

Another, I think, interesting figure to look at today is the fact that over 60 percent of the sales which my company is involved in represent, quote, "creative financing." This is unconventional financing. We are not going to the banks. No one can afford 17 and 18 percent interest. Therefore the majority of our sales are being made with owners taking back second mortgages, owners taking back first mortgages for periods of 3 to 5 years or assumptions of the existing mortgage. And it has already been discussed this morning that when you have a mortgage on a home with a low interest rate and it is in a good location, it will bring an absolute premium price.

As president of the Maryland Association of Realtors, I can say very authoritatively that the figures that I've quoted for Wicomico County, Md., will hold true for a very vast majority of our State. I think, Senator, that one-third off may be a conservative figure over the past 2 years. Again, if we couple the losses from 1980 versus 1979 to the 1981 losses as we are experiencing particularly this month, you may very likely find that the figures will show next month that housing was easily off 50 percent in the State.

As for the plight of the homeowner or the homebuilder who must sell his home, I want to say that it is a sad story indeed, when I say must sell his home. The discretionary seller is not in the predicament that the individual is in who has either lost his job or has been transferred. Every day in our office we are hearing the cries for help from the selling public, homebuilders, and the like.

Consider a situation where one has lost their job 6 months ago and has not been able to regain employment in his specified field and has approximately 30 percent equity in his home. He cannot make his mortgage payments. And unfortunately, Senator, he cannot sell his home because of the rate situation. His equity is dwindling, and he is on the verge of financial collapse. This is the story that we are seeing every day in our industry.

Foreclosures today are beginning to happen at a staggering rate. People cannot meet their payments, and unfortunately they can't get out, which is an even sadder commentary. It is a living nightmare for the seller that must sell.

New home starts are practically nonexistent in our area, as we understand that they are practically nonexistent throughout the State. Many of our area's leading builders are literally closing their shops, or at minimum they are laying off 50 percent of their crews. Those with significant inventories may soon fold. They simply cannot afford to carry large inventories at 22 to 23 percent interest.

It's no longer a case of profits for the homebuilders. For them, it is how much loss and how long do they have to withstand it and is there a light at the end of the tunnel. These are not, as we have discussed earlier this morning, companies that are marginally managed; these are well-managed companies with long, good reputations.

I submit to this subcommittee this morning for your record, Senator, 30 letters which I have picked up in less than a half a day's time from home sellers and home builders. I think, sir, that they will explain the plight that we are seeing in the general public's eyes today, and I would submit these for the record.

Senator SARBANES. We are happy to include those in the record at the end of your testimony. Thank you.

Mr. PORTER. I would like to stress that there is not a single letter in this group from a real estate agent or broker; these are from the public, which is experiencing the pain. I think they will also speak for themselves as to what the people are going through.

As for the real estate industry, organized real estate in our area, well-established, well-trained, professional real estate agents and brokers are having to leave our industry. This is, I consider, an extremely serious matter. We have always alluded to the fact that the weak will fall out and the strong will get stronger. This is not at all true today in the real estate industry. We have many people that have been considered over the years as the best of agents and brokers that have trained and worked hard and devoted their life to this industry to be the tops in the industry that are having to leave it for one simple reason, and it is called bread and butter on their tables and supporting their families.

This, to me, is a devastation which is beyond repair, as far as our industry. I sincerely hope that this committee will carry a message back to Washington, and I offer some of the following suggestions as we perceive it in the real estate industry.

First of all, we hope there will be further reductions in Federal spending, thus reducing credit demands by the Federal Government. We are not looking for subsidies in housing today.

Second, we are hoping that immediate attention by Congress to the plight of the Nation's thrifts and adverse effects of the money market funds that are creating—have created upon our economic system—there is no reason today, Senator, for yields of 18 to 19 percent to be given when we have a true inflation rate of 7 to 8 percent. Something must be done in the way of the money market funds.

Third, the Federal Reserve System must act quickly—and I mean it must act quickly—to reduce the stranglehold on this pentup economy. The tourniquet to the throat is not a cure for a bleeding finger, and this is the way the real estate industry feels today—that the tourniquet is around our throat and around the throat of the public.

Fourth, we encourage the use of the "all savers plan," which will be in effect October 1, unless the IRS kills it before it ever gets born.

In summation, Senator, unless we see a significant reduction in interest rates in the next 30 to 60 days, not only will the American dream of home ownership be a memory, but the entire economic base of this great country could be irreparably damaged for years to come.

Thank you, Senator. That is the conclusion of my remarks.

[The letters referred to by Mr. Porter follow:]

E.S. ADKINS & COMPANY *Everything Needed for Building*
LUMBER · MILLWORK ESTABLISHED 1893 MAIN OFFICE SALISBURY, MARYLAND
PLEASE ADDRESS REPLY TO
P.O. Box 1779
Salisbury, MD 21801

August 27, 1981

The Honorable Paul S. Sarbanes
United States Senate
2327 Dirkson - Senate Office Building
Washington, D. C. 20510

Dear Paul:

I am very pleased that you are holding hearings on the high interest rates because the housing industry is in the worst depression since World War II.

There is no market for new houses because when a working family's payments are in the range of $450 to $500 plus the cost of living increasing every month it is impossible for them to afford anything.

Our company in 1977 built 105 homes and had six crews constructing the houses. Today our company has four homes under construction, and to date we have constructed twelve houses this year and have two crews working on our payroll.

The housing industry is in a depression, and unless something is executed to improve the mortgage rates so families can afford the houses, there will be building materials and construction companies going bankrupt for the next year.

Sincerely,

E. S. ADKINS & COMPANY

Henry

Henry S. Parker
Vice President

HSP:dlr

Branch Yards
BERLIN, MD. - CENTREVILLE, MD. - CHESTERTOWN, MD. - EASTON, MD. - HURLOCK, MD. - OCEAN CITY, MD. - POCOMOKE CITY, MD. - SEAFORD, DEL.

August 31, 1981

The Honorable Senator Sarbanes
Washington DC

Dear Senator Sarbanes:

I am writing to you to express my concern and to ask your support, regarding the high interest rates we are now facing on home mortages. I have two houses in the $20,000 to $25,000 range that have been listed with local realtors for eighteen months now and are not being sold. I have spent extra time and money on the houses to make them more attractive for the market. This effort has proven futile and I'm being advised the houses have almost no chance of being sold until the interest rates come down.

I know you are aware of the "high interest rates" and I appeal to you to use the influence of your position and your office in trying to alleviate the situation. I know there are many others who find themselves in this "dead end" predicament. Is there not something you could do, through the proper political channels, to ease our efforts and start a down trend in interest rates?

I would be most appreciative of anything you could do.

Sincerely yours,

Dean Burroughs

Dean Burroughs
609 Twin Tree Road
Salisbury, MD 218

August 31, 1981

Richard F. Cropper
135 Francis Drive
Salisbury, Maryland 21801

The Honorable Paul Sarbanes
Senator, State of Maryland
State House
Annapolis, Md. 21401

Re: High Interest Mortgage Rates

Dear Mr. Sarbanes:

Please let me take this opportunity to explain the situation I'm presently faced with.

Due to my illness I'm having to sell my home. The house has been on the open market for approximately 6 months. During this six month period I've been forced to offer owner financing. Thus, of course, means we will have to rent an apartment in lieu of purchasing another home that would be condusive to our needs.

My wife and I are asking you to take action in the Senate that would result lower interest rates. We need your help.

Sincerely,

Richard F. Cropper

Richard F. Cropper

DUNHAM-BUSH, INC. HARRISONBURG DIVISION
on~~e of The Signal C~~ompanies

HARRISONBURG, VIRGINIA 22801 AREA CODE ~~703~~ 434-0711

August 27, 1981

Senator Paul Sarbanes
Unites States Senate
Washington, D.C.

Dear Sir:

I am writing to you to express my concern about the high interest rates that are causing major problems for most people today.

My specific problem relates to the fact that I am unable to sell a house due to the factors of high interest rates. My employment situation required that I move from Maryland to Virginia, approximately 250 miles in September of 1980. To date, my home is still on the Real Estate market. During this eleven month period, very few serious inquiries were made with no offers to buy tendered. My home is priced near the current national average home price and is located in a prime housing area. The only obvious cause for not selling has been identified by local Realtors as the high interest factor.

I urge you to consider taking action in the Senate that will effect lower interest rates. Perhaps many families could then again lead less financially taxing lives.

Sincerely yours,

M. J. Shroyer

M. J. Shroyer

MJS/sll

141N Lake Powell Rd.
Williamsburg, Va. 23185
August 26, 1981

Senator Paul Sarbanes
United States Senate
Washington, D. C.

Dear Mr. Sarbanes,

This letter is in reference to my home in Salisbury which has been on the market since February. This is a lovely home but has not been sold primarily because of the present high interest rates. It is proving to be quite a burden to me due to the fact I have relocated in Williamsburg and it is difficult for me to pay rent here and a mortgage payment there. Anything you can do to bring down the interest rates or make home mortgage money available at lower rates would greatly improve my chances for selling this property. If you need any further information

from me in regard to this home please notify me. In the meantime anything you can do would be greatly appreciated.

Thanking you in advance, I am

Yours truly,
Carol Lynn Wessells

HESS
Apparel's

JOHN E. HESS
PRESIDENT

DOWNTOWN PLAZA SALISBURY, MD. 21801 301-742-2111

August 27, 1981

The Honorable Paul Sarbanes
U.S. Senator, State of Maryland
State House
Annapolis, MD 21401

Dear Paul,

As I'm sure you are aware, the economic impact of the high interest rates for home mortgages is more than most of us would have believed possible. This has really hit home for us as we are in the process of trying to sell our home in Salisbury. Since originally putting the house on the market, we have had to come up with alternatives to offer prospective buyers, but with no success so far. Among these alternatives has been the lowering of our original asking price and offering owner financing at 12% (which is considerably under the market rates).

With the interest rates this high, it is almost impossible for any quick action on our house, and as you can imagine, this is affecting our ability to purchase another home. Until our present one sells, we cannot actively pursue the purchase of another place. Thus, to help 'move' our home, we are forced to find other means of selling it. These means affect us directly in a loss of money from the sale - not only by dropping the original price, but by taking a loss by offering owner financing.

I can't stress enough to you and the other members of the Joint Economic Committee how such indicators as lowering the price of homes for sale just to sell them shows the real economic impact of these high interest rates. I just wanted to add my voice to the many others throughout the state who are expressing serious concern over this economic problem.

Sincerely,

John E. Hess

JEH:lew

Calhoun Ave. Rt 6.
Salisbury Md. 21801
Aug 31 1981.

The Honorable Senator Sarbanes
Washington
D. C

Dear Senator Sarbanes:

We the American Public need relief from the high interest rates presently being Charged on Mortgages.

I am a Senior Citizen who has been trying to sell my home for many months but due to the high interest rates buyers are unable to afford the monthly payments. Any thing you can do in our behalf would be greatly appreciated

Sincerely,
Virginia Bennett

Rt. 3 Box 179
Delmar, Md. 19940.
Aug. 31st, 1981.

The Honorable Senator Sarbanes,
Washington, D.C.

Dear Senator Sarbanes,

The American people are in dire need of relief from the high interest rates presently being charged on mortgages.

My husband and I have been trying to sell our home for many months, but due to the high interest rates on mortages buyers are unable to qualify for the monthly payments. Anything that can be done for relief would be greatly appreciated.

Sincerely
Alice Faye Hopkins

Aug. 27, 1981

Dear Mr. Sarbines:

We would like to take this opportunity to inform you of our opinion of the current interest rate situation in Maryland.

We recently moved out of state and put our home on the real estate market with the expectations of lower interest rates this past spring. We anticipated our house being listed for approximately 6 months. About 9 months have now passed with interest rates going up, not down as expected. Living out of state with a home financed in Maryland, puts us in the position of renting until we sell our present home. This means that we have both a rent and mortgage payment each month and no opportunity to purchase another home until the one we now own, sells. With the interest rates as high as they are and the value of our home what it is, the potential buyers market for our home is very slim. In fact, if we were to buy our home at current interest rates, we would not be able to meet the mortgage payments.

We fully support any lobbying effort to reduce home mortgage interest rates. We feel the current interest rates are unfairly restrictive of young families who are trying to establish a solid and productive life style.

Sincerely
Lawrence D. Enders
Mrs. Brenda S. Enders

U.S. Senator Paul Sarbanes
United States SEnate
Washington, D.C.

27 August 81

Senator Sarbanes:

Due to a recent relocation with my employer, I find myself in the unenviable position of having a home on the market. I say unenviable because I find that today's buyer is facing a rate of interest that is double that which I financed only three short years ago. I also say unenviable because, like many others, I find myself in the position of paying this new , high rate of interest and trying to sell my other home at the same new, high, rate of interest. I feel as though I am between the proverbial "rock and a hard place".

I understand that you and your colleagues will be facing this issue in the near future. I emplore you as both a homebuyer and a home seller to try your best to voice the opinion of every Marylander in this situation. How can the home be the family base if the family cannot afford to own one?

Respectfully,

Guy W. Goeller
302 Park Row
Snow Hill, Maryland 21863

August 28, 1981

Dear Senator Sarbanes,

We are residents of Salisbury, and due to the high prices of fuel oil, we cannot afford to keep our home. We listed it for sale, in the Spring, with Porter and Donnie Realtors. Due to the terrible high interest rates: [illegible] and 18%, no one can afford to buy our home. Also, we have to relocate and with these high interest rates, it is difficult for anyone to buy or sell.

Can't something be done, we all need help!?

Thank you,

Mr. and Mrs. Nick Mantell
118 S. Division St.
Salisbury, Maryland
21801

Venables/LeCates, Inc.

Value Engineering
Construction Management
General Contracting
Development

1955 Northwood Drive
Salisbury, Maryland 21801
301-546-0008

August 27, 1981

The Honorable Paul R. Sarbanes
United States Senate
Washington, D.C.

Dear Senator Sarbanes:

I must start by yelling "HELP". As a builder I've just about had all of this great economy and rotten money market I can stand. In the last 18 years we have built and sold over 3,500 homes. But, because of the high interest rates, in the last two years we have sold one (1) home and that was a direct result of offering financing, only after the home had been on the market for a year and a half. Senator, it is not my aim to become a moneylender, but to remain a builder with my employees actively building homes and not actively seeking unemployment insurance benefits, something must be done.

After all these years I sure would hate to become a bank statistic or stand in line at the bankruptcy court. WE NEED HELP NOW!

Sincerely,

Richard T. LeCates

Richard T. LeCates
President

RTL/g

August 27, 1981

Senator Paul Sarbanes
United States Senate
Washington, D,C.

Dear Senator Sarbanes:

The high interest rates charged for mortgages in this country have very effectively eliminated our family from ownership of a home of our own. I believe that home ownership is a basic right for all families, but inflation coupled with the huge interest charged for mortgage money, has put the lower and middle class of wage earners out of the picture.

In order to buy a home in the price range we would have been able to afford just a few years ago would rquire us to pay about 2/3 of my take-home pay each month for principal, interest and insurance, and that is a sacrifice we are not willing or able to make. We have found several lending institutions willing to give us mortgages of 30 years on a $65,000 home, but our monthly payments would exceed $850.00.

Perhaps if interest rates could be cut by 15% and rolled back to 14-14½%, we would be able to afford to buy, but right now that is out of the question.

Yours truly,

Shearer family

Jon D. Shearer
Mary
Jon Jr.
Jim
Paul
Sue and Steve

303 W. College Avenue
Salisbury, Md. 21801

Princess Anne Md 21853
Aug 26, 1981

Honorable Paul S Sarbanes
United States Senate

Dear Sir,

I received your very nice letter a few days ago. In it you indicated that any problem that you could help with, you would gladly do so.

I am a widow with a very limited income. So much so that I had to take an apt, and put my large riverfront home up for sale. That was very difficult for me but it had to be done in order for me to live a reasonably comfortable life in the few years that I have left.

Unfortunately, the home hasnt been sold even though it is priced at what I consider a very low price, considering the size, condition, and location.

Several people have been very interested but the high interest has kept them from buying.

I will be very grateful if you will do all you can to get the interest rate lowered so that the average middle class couple will have a chance of buying a home for themselves and their children.

Sincerely
Mrs Edna M. Runkles
Princess Anne Md. 21853

Salisbury Md.
Aug. 30, 1981.

Hon. Paul Sarbanes
U. S. Senate
Washington, D. C.

Dear Senator Sarbanes:

Primarily, as a person besmirch-
ed with bronchial asthma for a good
many years, I am disgustingly shocked
at the state of the economy that breeds
nothing but mounting medical costs
that hit people like myself with chronic
Trouble, and gratefully thankful for
the protection rendered by medicare as
well as Blue Cross & Blue Shield. With
out these coverages the majority of us old-
sters would fare even worse, but
my doctors surely they get raises,
financially, with the spiraling costs of
keeping pace. Frankly speak-
ing I think any profession would take ad-
re the deficit is a difficult task
vantage of any kind of insurance contin-
ually drastically rising prices charged the public, easy to
~~the~~ if it was government backed,
obtain the money.

Now I am sixty-seven years, forced to
retire in 1971 (52 then) because of disability. a
doctor said he thought I would fare better
(over)

in a warmer climate. To give us a try
we spent the last six winters in effi-
ciency apartments in Florida. Having t[illegible]
rent there and maintain a house here is
a real [illegible] of stretching the inflation-
ary dollar. Finally, I put my house
up "For Sale", now on the market for sev-
eral years. I withdrew it last week,)
because we would have no place to move
to in Florida. If it had gone sol-
dly in the spring, could have found a ple-
ly now. As you know high interest
est rates are the real culprits knock-
ing the zip out of real estate sales. I
know this is supposed to deter infla-
tion, but don't you think enough pres-
sure can be exerted from all of us to
help bring them down. Incidentally, I have
to live on utility dividends and optical
securities without the dividends, I guess)
couldn't make it. Lower rates would surely
help them. People often ask, why don't you sell
these out and buy some of these high
interest bank certificates. That's the dec-
ision reasoning. As I would be the loser
with the lower prices of stocks right now.
Am surely in a quandary as you
note. Believe I have analyzed the sit-
uation correctly for the present (by keeping
my house here. If you have any sug-)
gestions, please send them to me. Yours

Respectfully,
William S. Purcell

August 28, 1981

The Honorable Paul S. Sarbanes
Room 1518 Federal Office Building
31 Hopkins Plaza
Baltimore, Maryland 21201

Dear Senator Sarbanes:

In August of 1980, I listed my three year old custom built home "For Sale" with Ahtes & Hanna Partners of Salisbury, Maryland. The property was listed for six (6) months at $82,900.00 which price was within the range of the market analysis provided by the salesperson. It was shown four (4) times and the listing was cancelled in February of 1981.

I again listed my house in July of 1981 with Porter & Dennis of Salisbury, Maryland at $79,900.00 and this time offered "Owner Financing" at 11¾%. The house has been shown a number of times and frequently advertised. However, the house is not sold and the real estate market in this area looks anything but bright in the future.

The purpose of this letter is to make you further aware of the financial crisis arising in this and many other areas of the country. Unless something is done soon to lower interest rates and make mortgage money available to home buyers many sellers will be forced to forfeit their homes because they are unable to keep up the payments. Also, some real estate salespeople may be forced to leave this field of employment because of the lack of business.

Due to the high cost of living and small pay raises, I would like to sell my house and live in something less expensive. I feel my house is in the price range of middle class income, but most local buyers would have to sell their home in order to purchase my home and even though I am able to offer owner financing, they cannot sell their home due to the high cost of interest rates and points.

I would appreciate your giving this matter consideration and in your job as United States Senator trying to recommend a solution to this growing problem. I am fully in favor of a "balanced budget" and doing away with "wasteful spending", however something must be done soon to lower interest rates.

Sincerely,

Vernadette M. Hudson

Ms. Vernadett M. Hudson
9 Weaver Drive
Salisbury, Maryland 21801

Robert L Davis
10134 Little Pond Place
Apt 4 Gaithersburg Md. 20879

August 24, 1981

Honorable Paul S. Sarbanes
C/o U.S. Senate
Washington DC

Dear Sir,

The purpose of this letter is to address the situation created by extremely high and fluctuating interest rates pertaining especially to mortgage interest rates.

My situation is as follows. Next May 10th we will have been married for 30 years. We purchased our first home in 1954 and have managed to build up equity. Our home was listed for 69,900 for an expected quick sale by evaluation of a highly reputable and respected real estate firm. Due to the relocation necessity required in my job I found myself in an unenviable situation. Having a 7½% mortgage (unassumable) I am now having to sell my home for 61,750 as appraised by my Company's relocation appraisers. This, I understand is a fair? and logical? method of arriving at a reasonable selling price to attract a buyer at today's high interest rates for a home which, had reasonable and sensible mortgage interest rates been available, would be, and is, worth many thousands of dollars more. My equity after 27 years of mortgage payments and appreciation of values due to inflation is $31,000. Since the consumer price index rose from 100 in 1967 to 249 in 1980 and even higher in 1981, thats a sad commentary, simply because with so many homes on the market no one can afford to finance a home for its real value.

To further compound my particular problem, I have been transferred to the Silver Spring area. I find that a comparable home or near comparable is in the $100,000 range.

To avoid taxes on my equity and (not) to buy an inferior home, after investing my entire equity, I would owe more than the total value of my prior home at interest rates approaching 2½ to 3 times my old mortgage rates.

I simply cannot afford to buy a new home at those rates.

Consequently, after 28 years of marriage we have sold much of our furniture and have moved into a 2 bedroom 2nd floor apartment at 2½ times rental as my old monthly mortgage payments.

My story is not unusual. I can live with it simply because I have to. I'm not happy about it and it seems to me that someone in your position may be able to find some solution.

I understand that a solution is more complex than meets the eye, consider this;

① assume the US Government has debts on which it pays interest

② Assume government pays lender say 3% of the interest on homes or mortgages up to say $70,000.

③ Assume lender has to invest in government securities the 3% of the interest it pays the lender.

④ assume the government retires the (govt debt) by the amount the lender invests, and pays the interest it otherwise would pay on the nat'l debt directly to the lender.

⑤ Ⓐ The government is no worse off.
Ⓑ The lender still gets his interest
Ⓒ Buyers can now buy homes at low interest rates because part of the interest payments are between the government and the lender.

Conclusion

Builders back to work, homes constructed
more homeowners, property taxes.
Realtors can make a living
Homeowners buy more furniture, landscaping, garden & home tools
Homeowners build equity as savings
Pride of ownership instead of at the mercy of landlords or evictions due to change to condos.
Self respect to renters due to stigma of can't afford to buy.

Happy hunting!

OVAL PEST CONTROL
EASTERN SHORE TERMITE CONTROL
DIVISION OF PIED PIPER PEST CONTROL INC.
P.O. BOX 2256 · 940 N. SALISBURY BLVD. · SALISBURY, MARYLAND 21801 · (301) 742-5550

August 31, 1981

Honorable Paul Sarbanes
U. S. Senate
Washington, D. C. 21510

Dear Senator Sarbanes:

Because of the high interest rates I have been unable to sell my house for the past three months.

People are in need of housing but they are unable to buy as they can not afford the interest rates and this hurts the economy.

It would be greatly appreciated if you do everything in your power to push getting these rates reduced as soon as possible.

Yours truly,

David L. Rice

David L. Rice
General Manager

DLR/gma

Haines Building Co., Inc.
1106 Kenilworth Drive
Salisbury, Md. 21801

Hon. Paul S. Sarbanes
United States Senate
Washington, D. C. 20510

Dear Sir:

I am writing this letter in regards to the high interest rate now being charged on mortgage loans. I am sure you are aware of this.

I think it is past time that someone should look into this and try to do something about it as this has brought the home building industry to an almost complete standstill in this area. I, as a home builder know that it has brought me to a complete halt in building and am sure that many are in the same boat that I am.

Would appreciate anything that you could do to get the building business on the upturn.

Thank you.

Very truly yours,
Haines Building Co., Inc.

H. O. Haines, pres.

806 Delaware Avenue
Salisbury, Maryland
August 29, 1981

The Honorable Mr. Paul Sarbanes
U.S. Senate
Washington, D.C.

Dear Sir:

I'm writing in regard to the recent lottery drawing of applications for the Maryland Home Financing Program (August 13, 1981). To our disappointment, our application was drawn 8th, of the which only 3 were chosen to be processed in Wicomico County. Frankly, I must tell you that the 9¾ % interest rate was our only hope of buying a home. We had looked into financing through the Farm Home Administration, but at our income (1980 – $19,000) even that is above our heads.

Sir, it's so hard for me to understand how that in this land that we call the "Land of Opportunity," only the very poor or the successfully rich are able to prosper. I am inclined to agree with those who say that politicians don't really care about the middle man – that reforms and proposals which are approved are made only at the discretion of the politician himself with no actual regard for those who work earnestly from day to day to make an honest living.

Is it so hard for those we've chosen for office to see that many of the programs which are being cut under the present administration are really hurting us?

(Over)

Is our government actually "for the people"? Does the fact that we are Christians, willing to abide lawfully and support our government legislation make us natural scape goals? As I see it, the weight of every decision made falls on those of us who work daily to make this country what it is.

Sir, my husband and I are hardworking people. He has worked at his present job (Delmarva Power and Light) for 14 years. I have worked as a seamstress since 1972. We've been married for 6 years and have 4 lovely children. We are currently jammed into a 2 bedroom house and we need housing. We want to buy a house in this community. We were both raised in this county and want a chance to effectively raise our own kids here.

We are therefore requesting more funds for financing. This program is one of the best that I have noticed for us "middle folks" in years. And sir, weren't you once one of those "middle folks"? I hope that you will reevaluate the whole matter and see the necessity of granting our request. You see, Mr. Sarbanes, one of my teachers once said that Maryland is "America in Miniature". I do so want to believe that in every respect.

Thank you for your time and cooperation,

Sincerely,
Mrs. Marvin J. Brown

State of Maryland
Department of Economic & Community Development

Single Family Programs
1910 Forest Drive, Annapolis, Maryland 21401 • 301-269-3524

Harry Hughes
Governor
James O. Roberson
Secretary

August 14, 1981

Brown, Marvin & Faythe RE: MHFP Lottery Number

Dear Applicant:

The Maryland Home Financing Program (MHFP) lottery was held on Thursday, August 13, 1981. Your application was # 8 drawn out of the 15 submitted for property in Wicomico County.

Based on program allocations for your county, only 3 applications could be accepted for initial processing. Therefore, your application along with others is being held on our reserve list at this time.

Should funds for your county become available as the result of rejections and/or withdrawals, applications will be placed in process from the reserve list according to their lottery number. Should your case be one of these, you will be notified promptly.

We should be able to determine total fund usage for your county within thirty to forty days. All applications not accepted for processing by Friday, September 25, 1981 will be mailed back to the applicant on that date together with all papers. Therefore, we ask that you do not contact this office to inquire as to the status of your application unless you have not heard from us by September 30, 1981.

Thank you for your cooperation.

Sincerely,

Alyce H Heath

Alyce H. Heath
Assistant Director
Single Family Programs

AHH:DLS:blr

Telephone Number for Hearing Impaired:
269-2609 Annapolis Area
565-0450 Toll-free Washington Area

An Equal Opportunity Employer

607 Pine Bluff Rd.
Salisbury, Md. 21801

Aug. 29, 1981

Dear Senator Sarbanes,

I am writing concerning the high interest rates, particularly those binding real estate. As I'm sure you're aware, they're too high to aid President Reagan's program and too high to afford most people an opportunity to invest in a home.

Surely Congress can help to alleviate the problem. I hope you will lend your support to reducing interest rates — it's too much pressure for the economic health of our nation.

Sincerely,
Mrs. Barbara P. Wilson

Arden Dr., Rt 6, Box 611,
Salisbury, Md., ~~21801~~
August 31, 1981GD

Hon. Paul S. Sarbanes
U. S. Senate
Washington, D.C. 20510

Dear Hon. Sarbanes:

As a prospective seller (and a future buyer) I am apalled at the extremely high interest rates for home mortgage money. Even if I find a buyer for my present home I'm not certain I'll be able to afford to purchase a different one of comparable quality.

It is my hope that you and your colleagues will endeavor to find some way to "relieve" the situation.

Sincerely,
Grace A. Ayers

426 Loblolly Lane
Salisbury, MD 21801
August 29, 1981

Hon. Paul S. Sarbanes
U. S. Senate
Washington, D.C. 20510

Dear Hon. Sarbanes:

High interest rates have made it impossible for people to buy properties. With the high rates, even families who have two incomes cannot afford payments.

I would appreciate anything your office can do to help reduce interest rates.

Sincerely,

J T Pastorfield Jr

James T. Pastorfield, Jr.
~~426 Loblolly Lane~~
~~Salisbury, MD 21801~~

~~JTP/lwp~~

Miss Evelyn Graham
Rt. 5, Box 316, Quantico Rd.
Salisbury, Md. 21801

Honorable Paul Sarbanes
Senator U.S.A. Senate
Washington, D.C. 20510

Dear Senator;

I have been trying to sell a little house, $32,500 worth, for over a year, and could have sold it a half dozen times, but the working class people, who are struggling to put food on their tables, can not afford the mortagage and high interest rates.

I know one senator has very little weight with this nationwide problem, but if enough people can pressure congress, and you use your high intelegance of pressure, I think some relief can be made.

I was compelled to rent my house, but was so hoping to sell and not have that worry in my remaining days, that are numbered.

Do what you can kind Sir, and we do appreciate you for what you are and what you are doing.

Sincerely
Evelyn Graham

Honorable Paul Sarbanes, Senator
United States Senate
Washington, D.C.

Dear Mr. Sarbanes,

I would like to express my feelings and the problems that the continuing high interest and mortgage rates have created in my life.

My husband died two years ago leaving me with a large house on 10 acres of land. My husband had been ill for awhile and it was hard to maintain the property then.

I put it up for sale immediately - but absolutely no action on it. Last September a contingency contract was drawn up on it - a family wants my home, but they need to sell their property first. A whole year has gone by and nothing has been accomplished because of the soaring interest rates.

(2)

I find it very hard to maintain my property and see it gradually deteriorating. My health is declining and I have no family to help me out.

I need to unload this property and move into an apartment.

My property is so ideal for this family. There I am rattling around in a big house all by myself. They, in turn, need to relocate here in Salisbury because of his business.

When is this situation ever going to ease? Can't there be more control by our law makers?

I would appreciate anything that you could do to bring this bad situation in the housing area under control. I do not understand why it has to be this way.

Sincerely,

Frances M. Williams
Brackett Lane Rt #5
Salisbury, Md.
21801

Phone # 749-9143

Walter Quimby
R.R. 1 Box 156
Goldsboro, MD.

August 30, 1981

Honorable Paul Sarbanes
U. S. Senator
Washington, D.C. 20510

Dear Senator Sarbanes

I am a resident of Caroline County. After graduating from the University of Maryland in 1968 and spending four years in the armed service, I moved from Baltimore to the eastern shore. Working in a management position for many long hours allowed me to invest in two farms and fully pay-off their mortgages. Additionally, I own my home.

Since I have always associated with the seafood industry during my working career, I purchased two commercial surf-clam boats in 1979. My farms and home were used as collateral on the boat's mortgages.

My problem is probably common among Americans today. However, it has been complicated by factors beyond my control, and I need your assistance. The government has regulated the surf clamming industry down to twelve working hours a week. That's right! I am registered to work from 5 AM Tuesday morning to 5 PM Tuesday night, regardless of weather conditions. Under ideal conditions, I could catch up to three hundred bushels of clams at eleven dollars per bushel.

For the past three weeks, weather has prohibited me from working. Yet, I am expected to pay monthly mortgages of $7000. to my banks, monthly insurance policies of $2400., crew shares, and other maintenance expenses. There is no way to survive on a negative cash flow.

Trying to maintain a portion of my life's equities, I tried to sell any or all of my investments at mortgage value (boats) or cost (farms). Nobody wants a boat that can't make money. Nobody will invest in a farm at today's interest rates.

Senator Sarbanes, I am about to face complete economic disaster! Before I do, I feel a need to ask my Senator a few questions.

1. What right does the government of a free enterprise country have to regulate clamming to twelve out of 168 hours every week? What about the men who earn their living from the sea?

2. High interest rates have crippled Americans and American industry. Emergency relief is necessary, yet we continue to work through typical government channels and red tape.

This is not my idea of America. The small businessman must survive, not just the giant conglomerates. Can you offer any assistance?

Sincerely,

Walter Quimby

1104 Kenilworth Drive
Salisbury,

To Whom It May Concern

I have a property located in Salisbury, Maryland that has been on the market fourteen months. It is a completely remodeled home, that was actually gutted and rebuilt. The home has been shown many times with great interest. It is in a excellent location by being close to the mall shopping center, walking distance to elementary and close to high school.

The last two people we talked to who had really wanted the property could not in any way pay the payments with the interest rate as high as it is. Because of the lost sales we have had on the property we are now losing every day because of the interest rate. The interest has now taken over any capital we had hoped to get on the property.

Unless the interest rates come down soon the cost of this property to us will be a great burden.

Very truly yours,

Senator **Sarbanes**. Mr. Porter, thank you for a very powerful statement.

Can I ask you what percentage of home resales involve some kind of owner financing today?

Mr. **Porter**. We are finding of the sales that are made within our company, Senator, approximately 60 percent of those sales are what we term as "creative financing." Creative financing is generally financing methods other than going to the bank or the savings and loan, which most people cannot afford today. They include owners taking back a first mortgage, if they are in such position to do so—and many are not; they may be owners taking a second mortgage. We are dealing with what is called the "wrap-around mortgage" today. There are more initials today on various mortgage plans than I think Webster's dictionary may have room for. But they are the unconventional methods. And as we stated before, the assumption is generally one of the fastest moving items on the market.

Senator **Sarbanes**. Are you finding the situation that the Governor referred to, that if there is an assumable mortgage at a favorable interest rate, it is then reflected by the seller in a higher cost of the home?

Mr. **Porter**. What we are finding is that—I would say yes, that home is going to bring a premium now. As to what percentage increase over the normal market, that is difficult to say, Senator, because the market attitude is such today that without the assumable mortgage, that property very likely will not sell to begin with. So it is a matter of being able to get what I consider to be market value today, whereas if you did not have the assumption, you are not going to receive market value because the price of the property will be discounted by the buying public.

Senator **Sarbanes**. You say that families required to move, because they have been transferred for business purposes or maybe a military transfer, find themselves in an extremely difficult situation; is that correct?

Mr. PORTER. That is very correct. Unless a family has what we call third-party relocation assistance——

Senator SARBANES. That is a point I wanted to get to.

Mr. PORTER. If their company has a plan—the employing company has a plan whereas their home will be purchased upon their being transferred, those people are not feeling the plight as much as the individuals who do not have such a plan or have lost a job in one area and have gone to another area in which to seek employment.

We are finding that many families in our area are even split up to the extent the husband is away perhaps in Wyoming or across the country working today, and the wife and the children are back home. Needless to say, this creates a tremendous social problem within our communities.

Senator SARBANES. One of the factors that needs to be developed is that, to the extent there is that third-party help, it generally works out as another disadvantage for small business. Usually, as we have examined it, it is the large companies that have such programs and are able to institute them. Therefore, they have a preferred position in seeking talented people, whereas the small or medium sized company that might be seeking the same person is unable to offer that benefit and it is at a disadvantage in attracting the personnel it wants.

Mr. PORTER. There's no question that this is the case, sir, because the small, even midsized companies very seldom have a third-party plan or a third-party brokerage coming in to take over the home, because it is costing the companies from 15 to 20 percent of that home transaction to have that company come in—that third-party company come in and take over the property. Small businesses can simply not afford this.

Senator SARBANES. Of course the cost the company incurs in order to do that ends up being passed on to the consumer of whatever product that company manufactures or whatever service that company provides. So again it contributes to an inflated cost.

Mr. PORTER. That is part of the cost of doing business, yes.

Senator SARBANES. Bill Byrnes testified yesterday at the hearing that we had in Towson, and one of the points he made was how much more difficult it has become just to be a realtor in terms of the personal dealings with people. I wonder how much you are encountering that problem in terms of the reaction of both buyers and sellers to the situation in which they confront in frustration and even anger. How much of that do you get, as opposed to a reaction of acceptance or resignation?

Mr. PORTER. Senator, I can easily state that we probably—when I say "we," the people within our company are spending up to one-fourth of their time each day discussing the problem of the market and trying to alleviate some of the frustrations of the sellers. I think we have been very fortunate that we have tried to keep ourselves abreast of the market changes, and I think they realize why people are not looking at homes today. Certainly they can read the newspapers as well as yourselves.

But we are continually getting calls in as to, "What's going on; is there any way we can get this thing sold? Should we drop the price; I can't offer creative financing. What can we do?" And we're spending a tremendous amount of our time just simply trying to pacify those sellers at this particular time. So it is becoming a very critical problem. We could get a lot more done if we could think a little bit more positively.

Senator SARBANES. That's right. A lot of your time and energy is really being spent on this. It is a very important activity, but it is essentially an economically nonproductive activity.

Mr. PORTER. That is correct.

Senator SARBANES. You made reference last summer to the fact that August was a very good month and that you sold, I think, as many homes in that quarter as over the year. What was the rate you were working with at that time, do you recall?

Mr. PORTER. Yes; when we saw the rates come back from 13½ or a 14 percent rate, which we saw in the spring months up until about May and June, when we saw those rates fall back into the 12 percent and the 11½ percent range, that is literally when the market opened up. And we had more sales in the months of July, August, September, and the first part of October prior to again the tightening of money by the Fed than we had during the rest of the year.

Senator SARBANES. Is that the range you feel you need to get down to to open up the market, or does that range keep creeping up?

Mr. PORTER. The range has crept up over the years, of course. In 1979, the early part of 1979, we were experiencing 10, 10½, and 11 percent interest. We find in our marketing area that 12 percent seems to become a magic number. We find that most consumers will accept that if there is an interest in buying. Thirteen, I guess by the mere figure of thirteen percent not having a good sound or for superstitious purposes, seems to be where we start picking up the drag or what we would call the back-off by the public, the rejection.

When you start getting in to 15 and 16 percent, Senator, it doesn't make much difference if it is 15 percent or if it's 20 percent, because then in our area we are beyond the affordability factors.

Senator SARBANES. Let me ask you this question, because of course the Fed argues that they are trying to restrict the economy to prevent it from overheating. I can understand that problem under certain circumstances, but I don't perceive that it is overheated. I think there is a lot of slack out there.

Would you say that at a 12-percent rate the doors are wide open or have they simply parted enough to allow a reasonable amount of activity to take place on your part, on the part of the homebuilders and on the part of the selling and buying public? Or at that rate, have you gone to such easy terms that everything is just gushing through?

Mr. PORTER. I would say that at the 12-percent rate the doors are not wide open. I think at a 12-percent rate we would find that the doors are open to the extent where we would have activity in the housing market, and I think good activity as compared to what we are experiencing today.

But as far as the doors being wide open, I don't think you're going to find that the general public is going to jump until you see single-digit interest rates, because you are still dealing with what we call the discretionary market, and that being the individual that is living in a home and is maybe a little cramped but otherwise comfortable, who has a 9-percent interest rate or a 8-percent interest rate on his home. He is not going to jump at 12 percent interest necessarily in order to move up to a larger home or a little more square footage or perhaps to try to improve his location factor.

The discretionary buyer, I think, is going to sit tight for quite a long time until we can see rates back into the 9- and 10-percent range.

Senator SARBANES. We had some graphic testimony to that point yesterday from a Mr. Grady, who is a gasoline station owner. He would like to move closer to his business. He has been very successful, and he can afford to do it, but he is not about to give up the low-interest mortgage he has now in order to assume a very high-interest mortgage—even though as he pointed out, it makes sense for a whole range of reasons—energy savings, environmental considerations—for him to make that move, and even though he can clearly afford to do it. There was some very strong testimony to that point.

Bill Byrnes said that he thought the realtors had succeeded in separating the messenger from the message as they deal with sellers and buyers, your clientele. Do you think that is the case? Or do you think people in effect are blaming you directly and therefore putting your business under even greater pressure?

Mr. PORTER. We're not finding that the public is blaming the industry for the problems we're experiencing today. Here again, I think it is a problem of communication between our industry and the general public. We have in many cases advised sellers, when they say "What can we do to get our home sold?"—frankly, Senator, we've advised them to write you and Senator Mathias letters, the President of the United States, and the Federal Reserve Chairman, if that makes them feel a little better, and perhaps it will have some impact. But I don't think that the individual public itself is blaming our industry for the interest rates. They know it's beyond our control.

Senator SARBANES. You've given some very strong testimony. I think it is very important to establish what is actually happening at the street level—at the grass roots—in order to make the point that a policy which simply accepts the current situation and says you just have to dawdle through, is not acceptable. The premise has to change; the premise has to say, "Something must be done about this," because we can't simply tolerate a situation in which certain sectors of the economy are literally driven into a depression, a situation in which productive, efficient enterprises go under.

It's one thing if you're saying, "Well, these were marginal operations, and it was really questionable whether they should have been in the business or not. These are the weak, and the competition was such that they fell by the wayside." My perception is as you stated, that that is not what is happening.

Some of your longest-established and most able firms have either gone out or have merged. I gather the number of mergers is up dramatically in the real estate business. Therefore, the premise has to change, so that we say, "We have to address that situation and make changes elsewhere in the mix of our economic policy in order to bring down these high interest rates."

Mr. PORTER. I think the attitude today of the real estate industry is that we have had enough. We have supported much of the economic programs that are before Congress today, including the tax cut programs, but I think we have to look back and realize the fact that back in January through March of last year, we were dealing with 14-percent interest rates with the expectation that a new economic program was going to make that situation improve. And it's a little difficult today to look a real estate agent in the face and say, "Well, things are going to get better," when they have gone from 14 to 18 percent in a period of, say, 3 to 4 months. It is a bitter pill to take, and I can assure you, Senator, that the real estate industry is getting up in arms about the situation.

I could have brought with me today 100 letters from the public. I could have brought you 300 letters from real estate agents on the Eastern Shore, had I had the time. I moved my schedule forward to this morning, but there are other boards of realtors on the shore other than the coastal board that have also accumulated letters that will be coming into your office that I would have been picking up this morning.

Senator, there's no plight about the experience we in our interest are going through. I think all you have to do is go out and talk to the public to see what the effects are.

Senator SARBANES. Thank you very much for some very good testimony Mr. Porter.

Mr. PORTER. Thank you.

Senator SARBANES. I want to acknowledge the presence at the hearing of Delegate Gerald Winegrad of Annapolis, who is one of the most effective members of the Maryland House of Delegates. Gerald, we are very appreciative of your being here with us this morning.

Has Mr. Yates come in yet?

[No response.]

Senator SARBANES. I think I will defer the next panel, and we will introduce the State Commissioner of Consumer Credit, Alan Fell.

STATEMENT OF ALAN THOMAS FELL, COMMISSIONER OF CONSUMER CREDIT, DEPARTMENT OF LICENSING AND REGULATION, BALITMORE, MD., ACCOMPANIED BY GEORGE RAYBURN, ASSISTANT COMMISSIONER

Mr. FELL. Senator, I want to thank you for the opportunity to come here and speak for some consumers who have contacted us. Some consumer groups, senior citizens groups that I've spoken to that have given me their views. And I would like to give you their views.

Forty percent of my statement has been extremely well covered by both Governor Hughes and yourself. I had five different subjects I wanted to talk about. You and the Governor have very well covered better than I could that the record rates have caused an increase in the price of goods, and publicity concerning record high interest rates has resulted in the loss of consumer confidence.

I would like to go into some other areas which may not be covered today by other speakers in an area in which we feel we have some expertise.

On my left is George Rayburn, the assistant commissioner, and my right hand for the last 13 years.

Senator **Sarbanes**. You sat your right hand on your left.

Mr. **Fell**. Yes. That's not unusual, Senator. [Laughter.]

The installment sellers are finding it difficult to sell their financing contracts or hold their own paper. These installment sellers are basically small, independent Maryland merchants who are unable, because of high interest rates, to carry their own paper. These could be automobile dealers. They could be appliance dealers.

In addition to them finding that their sales are down—that is one question that you and the Governor very well went over. But they have another problem. In addition to their sales being down, their contracts when they purchase this are so difficult because to hold it, because of the high interest rates, they try to sell this to a factor. They are unable to sell them, because interest rates are so high, nobody wants these contracts. Now they can make more money putting this money into money markets mutual funds or CD's or whatever.

So the small independent Maryland merchants that sells installment goods is hurt and hurt badly, and I do not know how they are going to survive a great period of these high interest rates. If they would decline soon, I think we would be in good shape. I think Maryland is in better shape than most States to perhaps withstand this, but we can't stand this forever.

So the small merchant, I think, is a person who is greatly affected by these record rates. I want to get into the fact that credit is scarce for consumers who do not have well-established, and I said in my prepared statement, prime credit ratings.

Inflation affects the poor and those who do not have prime credit ratings more than it affects those who do have prime credit ratings. The reason for this is when money gets expensive, it also gets tight. And the more creditworthy borrower by credit bureau standards, not necessarily saying that they are more creditworthy or less creditworthy, but I am talking about how they are rated by the credit grantors and the credit bureaus.

These people who have not established credit or several years ago may have had a judgment or may have had an automobile repossessed, they are greatly affected, because they are going to find credit is expensive, if they can get it.

For example, consumer loan companies usually aid people that are unable to get bank credit or who have exhausted their bank credit. These companies are at a record low in Maryland. Mr. Rayburn just checked and we have 262 licensed companies from a record high of, I believe, 452, and a high 2 years ago when they passed a new law, 355. So it is really 355 against 262. These businesses that have gone under have cost us jobs. They have cost us empty places in shopping centers, and they have cost the people that are unable to obtain bank credit a source of funds.

And these people are the ones that are being affected most by these record high interest rates.

Finally, I want to get into a industry that has benefited—I'm sure you're going to hear today tales of woe from various industries and consumers and individuals—well, there is one industry that has been booming as the result of this, these record high interest rates, and also the scarcity of money, and that is the collection industry. The collection industry in Maryland has gone from 125 licensed companies, and I may add some of these companies employ as many as 50 or 60 people. It has gone from 125 in fiscal year 1978, which is the first year of our licensing law, to 217 currently. In addition to that, every month we're getting more applications from other people that want to get into the collection business.

So this is one area that has benefited from the current economic problem. The reason for this is the expense of carrying these debts on the books is so great that collection agencies are being used more now than ever before to liquidate these debts and, therefore, they have increased tremendously, and we expect them to continue their collection activities on the public.

That, Senator, basically is my testimony. I would be glad to answer any questions that you may have.

Senator **Sarbanes**. Thank you very much, Commissioner. It is a very helpful statement and your full statement, of course, will be included in the hearing record.

[The prepared statement of Mr. Fell follows:]

PREPARED STATEMENT OF ALAN THOMAS FELL

Record high interest rates have affected Maryland consumers in the following ways:

1. *These record rates have raised the cost of consumer goods to both cash and credit customers.* Merchants and manufacturers have had to raise the cost of goods since their cost of carrying inventories has become almost prohibitive. In addition, most merchants are currently losing money on their credit plans; and, they are forced to raise their retail prices, in effect, subsidizing the credit purchasers.

2. *Installment sellers are finding it difficult to sell their financing contracts or hold their own paper.* These merchants have been calling our office in record numbers and have testified before the Maryland Legislature that they can no longer carry their own paper with today's interest rates. Finding someone to purchase these contracts with today's cost of money is extremely difficult especially for the small installment seller.

3. *Credit is scarce for consumers who do not have well-established "prime" credit ratings.* For example, consumer loan companies serve consumers who have exhausted or are unable to obtain bank credit. These companies over the past nine months have closed their doors in record numbers. As of this moment, as shown in our table, we have the lowest number of licensed consumer loan offices in the past 30 years. Every month we are being notified of more office closings. The local independent loan company in this State is rapidly becoming extinct due to the high cost of money. Many independents have to pay up to five percent over the prime rate for the money they lend to consumers. Those consumer loan companies which continue to operate have had to restrict the availability of funds to their customers.

Second mortgage loans are also becoming scarce in Maryland. Most of our second mortgage lenders began curtailing second mortgage lending 6 months ago and have continued these restrictions to the present time.

4. *Publicity concerning record high interest rates have resulted in a loss of consumer confidence.* Prospective buyers considering the purchase of motor vehicles and other large ticket items which must be financed are in many cases deferring

purchases until interest rates decline. The high cost of financing has a direct effect on consumer confidence.

5. *Collection activities have been increased.* Not every industry has suffered from these record high interest rates. The collection industry in Maryland is booming. The number of collection agencies licensed to do business in Maryland has increased from 125 in fiscal year 1978 (the first year of the new licensing law) to 217 currently. The number of these collection agencies has been steadily increasing every month. Both business and collection agency executives have confirmed that debts are more expensive to carry on the books and therefore must be liquidated as soon as possible.

I wish to thank the subcommittee for the opportunity to present the views of my agency.

CONSUMER LOAN LICENSEES IN MARYLAND

Calendar year	Number of loans made	Total dollar amount of loans made	Year end outstanding
1978	169,462	$440,040,963	$418,600,989
1979	236,145	420,117,566	434,965,938
1980	140,246	215,629,170	356,120,198

The number of loans made calendar year 1980 compared to calendar year 1978 shows a decrease of 52.05 percent.

The total dollar amount of loans made calendar year 1980 compared to calendar year 1978 shows a decrease of 49.0 percent.

Senator **Sarbanes**. Mr. Fell, on the first point, which was alluded to earlier, that the rates have raised the cost of consumer goods to both cash and credit customers, have you seen that happen? I assume there has been a sharp curtailment in inventory, which a lot of merchants are carrying; is that correct? Just because of the high cost of carrying?

Mr. **Fell**. Yes, sir.

Senator **Sarbanes**. I know the auto dealers, in particular, are confronted with that problem.

Mr. **Fell**. Yes, sir.

Senator **Sarbanes**. Do you have any estimate of the increase in the cost of goods that is resulting from this increase in the cost of money?

Mr. **Fell**. Mr Rayburn has informed me that it varies from merchant to merchant, but I want to get one other thing on the record too that is in the statement. But I want to expound upon it. The credit plans that the merchants offer, they have testified before me and before the legislature, they are taking a loss on those. So they are forced to increase the cost of the cash goods, and not only do you have high interest rates causing an increase in the goods, because it is the cost of doing business, you have another side of the coin, where the credit plans, the revolving charge accounts that the merchants are giving, they are not making any money off of those, because of the high-interest rates that they are paying for money, so therefore, they are raising the cost of the goods again, not only because of money, but they're raising the cost of goods again to support the credit plans which they are losing money on.

So it is a double effect on the cost of consumer goods.

Senator **Sarbanes**. On the second point, are they finding people to carry their paper at a very high cost, or are they actually finding that they can't find anyone to take their paper at all?

Mr. Rayburn. Senator, we receive or have received a number of letters and complaints, I guess you could say, from small merchants, mainly furniture and appliance dealers, who have advised our office that they can find no outlet for their paper. They are forced to do one of two things, either hold their own credit paper or restrict the sales to cash customers.

There are many buyers in this State who cannot afford to go out and buy a $500 or $600 refrigerator, when their other one breaks down, and pay cash for it. So as a result, we have a mounting problem, not only insofar as the merchant is concerned, restricting inventory, restricting his sales to cash customers, and so forth, we have a consumer in need who is forced by the market to go into a consumer loan company and borrow this $500 or $600 at very high rates approaching 30 percent, because he cannot buy on an installment plan that carries a 20-percent rate, because the merchant cannot factor that paper at 20 percent, when the factor could get more money than that from—for his funds through a commercial enterprise.

Senator Sarbanes. So the consumer ends up paying 30 percent where he might have paid 15 percent or thereabouts or even less, if we had a normal interest rate situation?

Mr. Rayburn. Absolutely.

Mr. Fell. If the high-interest rates continue, we will probably have an increase in an area which I don't even like to talk about, because in Maryland we have eradicated this evil pretty much. But if these high-interest rates continue and legitimate businesses are forced out of business, we will see a return to the loan sharks which were prevalent in this country especially after World War I, and the Russell Sage Foundation conducted a study after World War I, and they found that if you don't have legitimate controlled lenders lending money, and these people should go out of business for some reasons or for some reason not be in business, then people must find money somewhere. And when there is a need, and when there is no legitimate business to take that need, to help that need, we will find ourselves in the position, I would say, if these interest rates continue, say, for another 2 years, we would find ourselves in the position where this ugly monster, which I think we have almost eradicated, will raise its head again. That is, the loan shark. And I don't look forward to that happening.

Senator Sarbanes. I don't think anyone does.

Let me ask this question. are the large concerns able to handle this problem and, therefore, gain a competitive advantage, over the small furniture dealer or the small durable goods retail store that you've been talking about?

Mr. Rayburn. As far as retailers are concerned, it is obvious that the larger the retailer, the better able he is to absorb this particular impact. It is the store that is a specialty store, that deals only in, let us say, furniture and appliances or deals only in ladies' wear or only in mens' wear. The general merchandise store that has many branches, and so forth, is better able, because of their spread, to absorb the particular impact of these high-interest rates; however, there is a strong question as to how long they will be able to absorb this. They are already petitioning the General Assembly of the State of Maryland to increase the rate.

They have testified before the Senate Economic Affairs Committee just recently as 2 weeks ago, that they cannot continue this indefinitely. And I'm talking about the Retail Merchants Association of Maryland, which comprises every major retailer in the State, including Sears, Ward's, and so forth. They generally hold their own paper, but they cannot continue to hold their own paper or work through a factor, when the factor will not advance them funds.

And there is a question of liquidity, cash flow, and so forth, which is much too complex to get into here. But I'm certain that you understand, and the subcommittee will understand these problems as they go along.

Senator SARBANES. Well, gentlemen, this has been very helpful testimony, and we appreciate your effort in preparing and appearing before this subcommittee.

Mr. FELL. Thank you, Senator.

Senator SARBANES. I have two people testifying for the financial institutions, Mr. Hendrix and Mr. Yates. Are they both here?

Mr. HENDRIX. Mr. Chairman, I'm here.

Senator SARBANES. Mr. Hendrix, can you wait a bit to see if Mr. Yates comes?

Mr. HENDRIX. I'm at your pleasure, sir.

Senator SARBANES. We have the Maryland State Home Builders scheduled next, and I think they are all here. And if Mr. Yates doesn't get here, we will be honored to have you alone.

So gentlemen, if you would come forward and if you would identify yourselves for the reporter to start out with that would be helpful.

STATEMENT OF CARL T. BUSCHER, EXECUTIVE VICE PRESIDENT, STATE OF MARYLAND INSTITUTE OF HOME BUILDERS, INC., BALTIMORE, MD.

Mr. BUSCHER. Senator, I'm Carl Buscher, executive vice president, the Maryland Institute of Home Builders. To my left is Hugh Gambrill from Marlton Construction Co., who is president of the Anne Arundel County Home Builders chapter. To his left is Stanley Orlov, a homebuilder in this county, and to my right is Richard Priddy, who is a homebuilder in this county.

Senator, I would like to make my statement, and then Mr. Gambrill would like to make some comments, and I think all of us would like to relate some personal experiences and answer your questions.

I am pleased to have the opportunity this morning to tell you, Senator, that the homebuilding industry in Maryland and throughout the Nation is simply drowning in the sea of high interest rates. The current rates are about that loan sharks charged just a couple of years ago and have replaced inflation as the Nation's No. 1 economic problem.

Both the Carter administration and the Reagan administration have pursued this high interest rate—tight money—policy for some 2 years, and frankly, this policy hasn't worked. It is adding to the cost of government and is driving many small businesses and builders to the brink of financial disaster and bankruptcy.

We know that President Reagan inherited a very weak national economy and his program to cut taxes and reduce Federal spending has changed the course of events in Washington. But President Reagan and the Congress now must address the problem of high interest rates before we can expect to mount and sustain any national economic recovery.

From the Federal Government standpoint even more distressing is the now-acknowledged fact that the tax cuts planned far exceed budget restrictions adding billions of dollars to the already swollen Federal debt burden.

The Federal Reserve Board's tight money policy—reinforced as recently as this past Sunday on TV by Chairman Volcker—coupled with lower government tax receipts from a contracting national economy, can only indicate that rates will remain high for the foreseeable future. Mr. Volcker proudly said on Sunday that he fully expected high interest rates for at least another year or so.

Congress approved the President's economic program recently and America was assured that this approval would bring rates down quickly. However, as you well know, interest rates have continued to climb. People cannot buy homes or home improvements, or cars or nearly anything else on credit. The spread between the prime rate and the Consumer Price Index is now over 12 points, when it usually and normally is between 3 and 4 points.

Senator, it has long been a goal of our industry that homeownership can and should be within the reach of every American family. In the 1960's, the Congress adopted a national policy calling for "a decent home for all American families."

The last 2 years have seen inflation and record interest rates push the cost of owning a home beyond the reach of a vast majority of our citizens. Many families in the middle income bracket can no longer qualify for home mortgages. Even the FHA/VA rate is beyond the reach of many potential buyers, including many veterans. Statistics of the U.S. Department of Labor show that housing starts in Maryland are about 50 percent lower than 2 years ago at this time.

And let us talk for a moment about the loss of jobs in our industry during this tight money policy of our Federal Reserve System. With new housing starts down 50 percent, a lot of construction workers in Maryland are out of work. Many of these people may not return to our industry when interest rates come down, and we are asked to gear up for greater production. Many of these people are skilled in their trades. Replacing them will not be easy. An immediate lowering of interest rates would greatly assist in bringing these people back to work and off the unemployment rolls.

Builders fully support Senator Melcher's Senate Joint Resolution 104 which could be a vehicle for congressional action on high interest rates this fall. This resolution requires the President to immediately begin consultations with the Fed to modify its policy in connection with its reserve requirements, open market committee operations, and its discount rate so as to substantially reduce interest rates within 90 days.

Senator Sarbanes, we urge your support for Senate Joint Resolution 104.

We cannot hold on much longer. We cannot fulfill our traditional role of being the supplier in this nation's supply and demand economy. Although there are many American people who need and desire housing, without proper financing, we cannot help them, and they cannot qualify for housing.

For a nation that prides itself on being the best housed nation on earth, we are not able at this time to participate in Congress stated policy calling for a decent home for every American family.

Senator, if the monetary policy doesn't change virtually immediately, we are headed for disaster.

On a personal note and in conclusion of my statement, I accepted my present position here in Maryland here a year ago, moving from another State, and I still have not been able to sell my own lovely home in that other State, and until I do, I cannot buy a home here. I am sure you understand the difficulties that can occur when I live here, and my wife and children live in New Jersey, and I get back only every other weekend.

Thank you. And I think Mr. Gambrill would like to make a statement.

Senator **SARBANES**. Thank you, Mr. Buscher, that was a very powerful statement.

Mr. Gambrill.

STATEMENT OF HUGH H. GAMBRILL, PRESIDENT, ANNE ARUNDEL COUNTY CHAPTER, HOMEBUILDERS ASSOCIATION OF MARYLAND, SEVERNA PARK, MD.

Mr. **GAMBRILL**. Thank you, Senator.

Even though some of this is repetitious, I have prepared a statement which I would like to read.

My name is Hugh Gambrill. I am president of the Anne Arundel County Chapter of the Homebuilders Association of Maryland.

I am here today to protest the high-interest rate policy of the Federal Reserve Board and to urge the administration and Congress to take whatever action is necessary to change their cruel and senseless policy.

Because of the policies of the Federal Reserve Board, in Anne Arundel County building permits through July of this year are down as much as 50 percent from previous years and getting worse.

In a county such as Anne Arundel, which is not heavily industrialized, homebuilding is a vital part of the local economy.

According to the Regional Planning Council, normal market demand would have the building industry produce 3,500 units annually. At an average price of $75,000, this represents annual sales of $260 million.

And according to economists at the National Association of Homebuilders, the true economic impact of this is found by using a multiplier of at least two times. The full economic impact can then be calculated to be at least $500 million.

This means that, with building activity off by more than 50 percent from where it should be, that the loss to the county is more than a quarter billion dollars.

In human terms, it is worse. According to the U.S. Department of Commerce, each new house represents 1.7 man-years of employment. For Anne Arundel County, this means almost 6,500 jobs in a normal year. The current drop in building means the loss of more than 3,000 jobs.

We want to know when this is going to end.

If I may, I would like to quote from a legislative bulletin from our National Association, which I believe represents fairly the feeling of builders here in this county:

Congress has approved the President's economic program. We were assured that approval of the program would bring down interest rates quickly. However, recently even administration economists have been saying that interest rates will continue to stay high at least through the end of the year.

High-interest rates are a result of the Federal Reserve Board's tight monetary policy to fight inflation along with high projected budget deficits.

Current interest rates are much too high based upon the current inflation rate—the spread between the prime rate and the Consumer Price Index should be about 3½ to 4 points; today the spread is over 12 points.

A tremendous amount of credit has been diverted to corporate takeovers, which further restricts the available credit for small business, including housing. Some $35 billion in credit was tied up by large corporations during the recent bidding war for Conoco.

In conclusion, I feel that if this does not get the attention of elected officials now, I think that elected officials will be dealing with it this time next year when it comes time for elections.

I would just like to add a personal note if I may. I am a small homebuilder. And as you probably know, the majority of the homebuilders of this country are small homebuilders, they are not the big giants. And we can't stand to have these big losses—like we see in the newspaper of General Motors—of billions of dollars. We just don't have that to start with.

Two of our members here recently were foreclosed on by their construction lender because they couldn't sell their houses. And what will happen to them now, I don't know, because they are not going to get any guarantee from the government, when they go back to borrow money, like some of the giants do.

So, unless we can sell our inventory and move our houses, why we are in serious trouble.

Thank you.

Senator **Sarbanes**. Thank you, sir.

Did anyone else want to add anything?

Mr. **Buscher**. Mr. Orlov would like to make a statement.

STATEMENT OF STANLEY ORLOV, HOMEBUILDER, BALTIMORE, MD.

Mr. **Orlov**. My name is Stanley Orlov, and I'm a homebuilder. And like many of the other gentlemen, I do not have a prepared statement. But I would like to speak extemporaneously and point out some things that are our problems.

All we are attempting to do is—not to make profit today, but just to hold on. But we have heard continuously today about interest rates, 10, 12, 15, or 17 percent. What do they really mean to the buyer?

Let's relate to what that is talking about. And as a result, I have brought a mortgage book. And one of the gentleman said that he felt that 10 or 11 percent could move the market. A monthly payment on a $60,000 mortgage at 11 percent is $571 a month.

A $60,000 mortgage at 14 percent is $710.93 a month. This is, now, for pure principal and interest, which is roughly 33⅓ percent increase.

The same $60,000 mortgage at 16¾ is $843.24, or 50-percent higher than the 11 percent.

Now, the problem is qualifying the people. There has been a standard rule for many years in the industry that usually 28 to 30 percent of a person's income should not be more than the mortgage payments.

As you can see, with the $800 a month payment, a husband and wife would have to be making a joint income of $40,000 to $45,000, not taking into consideration their real estate tax, their fire insurance, and so forth.

Now, what is happening on top of that is the fact that we, as builders, in order to, as an example, bring that interest rate down to a 13½ percent or a 14-percent rate, which is 33⅓-percent more, we are being called on to reduce that mortgage by paying 9½ to 10 percent, 10 points, on the amount of the mortgage.

So that if a person is taking out a $60,000 mortgage, we are paying $6,000, or roughly between $5,000 and $6,000 for those points, which we, in turn, must add into the price, and which is increasing the price for the buying public.

He now needs to make more income in order to qualify for that same home.

What has happened with the buying public, they fully realize this. They fully realize they can't afford it. And as a result, they are just plain not interested. No matter how you are talking to them, you cannot convince them that prices are going up. And even our suppliers, in the last week or 10 days, have notified us that on our contracts that are expiring for supplies at the end of September and October, our prices will be increasing some 10 percent.

Now, what do we really do? There is nowhere to turn. There is no traffic. Our prices are going up. The public can't buy it. Our subcontractors are being hurt.

Just yesterday I spoke to a subcontractor that was doing our drywall work, and he had some 250 employees on his payroll a little over a year ago. He is now down to 18.

And so we are finding it in each and every one of the trades. It means constant unemployment, that, as we mentioned, we are feeling the complete effects of all of these things.

The builder, as was mentioned, cannot stand it. There is no way possible that we can build a product, stay in business, without selling the product. We can't sell the product. The answer is the interest rates—not in interest, but in dollars which they produce.

Thank you, Senator.

Senator SARBANES. Thank you, Mr. Orlov.

Mr. Priddy.

STATEMENT OF RICHARD PRIDDY, BAY SHORE HOMES, ANNAPOLIS, MD.

Mr. **Priddy**. Senator, I would like to make some rather fragmented remarks. I did not come with a prepared statement, but I have heard many statistics alluded to, and oftentimes these statistics do not tell the whole story.

You have heard several people today testify about the fact that the home sales are down significantly over the last 2 years. Because of the way these statistics are taken, they do not indicate the difference between home sales of new homes and home sales of used homes.

If all home sales are down 50 percent, new home sales are down considerably more because they cannot offer the creative financing. We are not able to offer creative financing. We have no assumable mortgages.

These statistics that you've heard today on unemployment do not reflect underemployment. You heard considerable testimony about the number of people who have lost their jobs, but I have heard nobody talk about the carpenter who is used to working a 6-day workweek and now is working 2 days a week and trying to support his family on that same income.

It does not reflect that perhaps this small contractor, or many small contractors, or one or two individuals cannot collect money for the work that he does, what this does to his business.

We have heard statistics today on housing starts and how significantly they are down. They, again, do not tell the whole story.

A factor of lending is that, oftentimes, to borrow money against assets, a builder must obtain building permits. Statistically, these are considered building starts. Frequently, they are not.

I would say that, of the building permits that I personally have obtained this year, only about a third of those actually have gone into construction. The rest of those building permits were obtained to sell a lot, to finance a lot, that type of thing, and may not be built on for another 6 months a year.

We have heard about the interest as a cost of doing business in various businesses. Unfortunately, the housing business is the most credit-sensitive business in the country.

I recently priced a home that I was selling for $145,000 in my community for the second section. I had to add $10,000 to the cost of that house for my financing costs. The customer that buys that house not only has to pay the exorbitant rates that are required today. But in order for me to obtain construction financing and in order for me to obtain permanent financing, I have had to add $10,000 to the cost for that financing.

Something that I very seldom hear anybody talk about is the effect of the high cost of housing, is the effect that it has on the family. Where 5 or 6 years ago, I would normally sell a house to a one-worker-in-the-household family, this is almost unheard of now. If a couple wants to buy a house today, they almost have to do it on the joint income of the husband and wife. You, therefore, have people with young children. Perhaps a mother would much prefer to stay home and raise that child, but she has no choice today. If you want to buy a house today, you have to make a choice between raising the child with the mother at home or working and buying a home.

The cost of money to the housing industry is staggering. I have heard several witnesses bring up the fact that we are almost in a crisis. We are not almost in a crisis; we have been a crisis. The crisis is here today.

I don't know of one businessman in my business that is not struggling, and struggling to a considerable extent. We need action right away, not in 6 months, not in 3 months, but in 30 to 60 days.

Senator SARBANES. Gentlemen, this has been a very good panel. I think you have given us some very helpful testimony.

Let me make just a couple of comments.

Mr. Buscher, I want to start from something you said, that there is a concern about the Federal deficit. Well, my perception is that the high interest rates are helping to contribute to it in a number of significant ways.

One is it obviously makes the carrying charge on the Federal debt much greater, just to start with.

Second, it is reflected in the cost of what the Federal Government buys, since the cost of money is being passed through by the supplier to the Federal Government as part of his cost.

And third, and perhaps most importantly, to the extent that it induces recession in sectors of the economy such as your own, people who were formerly working and producing and, therefore paying taxes under this program, as you have pointed out, are no longer working and producing. Or, as Mr. Priddy has pointed out—and I think it is a very good point that is often overlooked—there's a great tendency to talk about the person who becomes completely unemployed, while we tend to overlook that person who was working a full week and now continues to work on a part-time basis.

Every time that happens, you are taking people who are wage earners and taxpayers and leaving them idle, even though they have very important and vaulable skills that we ought to be using.

That recession, as the Governor pointed out earlier this morning, affects the State budget, and revenues fall off. It obviously affects the Federal budget, whose revenues also then fall off.

I think it is very important to recognize that many of the objectives that this high interest rate policy is meant to accomplish are not achieved. In fact, the policy works exactly against the objectives that we are talking about. The policy therefore contributes to the problem rather than solving it.

I wanted to ask about your work force situation. It is something that has concerned me a great deal in the homebuilding industry, because I have a feeling that the boom-and-bust cycle is very bad for the efficiency of the homebuilder's work force.

I am very interested to know how real that problem is and how much this up-and-down cycle affects your ability to assemble and maintain a skilled and efficient work force.

For instance, what happens to your good people when you lay them off? I take it that in some instances, it is hard to get them back when you eventually want them. What does it mean to a homebuilder who has put together a fairly efficient, functioning work force, a unit that is integrated and trained, when he has to bust it up?

Mr. **Buscher**. It is good teamwork. I think the homebuilders at the table can probably respond to that very well.

Mr. **Gambrill**. Yes, Senator. The huge majority of our work is subcontracted.

As Mr. Priddy has already referred to, some of his contractors who have cut their force way down, each and every department has cut way down.

In our own organization, we had three excellent carpenters. They are now drawing unemployment compensation, hoping that we will be calling them back sometime in the near future. In the meantime, they are trying to pick up little odd jobs. They are out building back porches if they can get it, making small home improvements for people in the neighborhood, a little carpentry work here and there. But all of our subs have cut down; all of their forces are cut way back—our electricians, our mechanical men, everyone has just cut way back.

Mr. **Priddy**. Senator, I would like to also respond to that.

There are a significant number of subcontractors that have skills where they can get odd jobs and survive these downturns. Unfortunately, a large number of the people that work on our homes are less skilled tradesmen, and the work that they do is not as easy to pick up on an odd-job basis.

For example, a drywall installer—I can relate back when we had the 1974–75 downturn, and then when it started up again—I had just started business—it was almost impossible to get drywall work down during the month of July and August, because this was the first return of a good building industry. There was so much drywall work available, but they would call their former employees and find out that the guy was working at a local food market as a cashier. And, of course, a job as a cashier paid better and was a heck of a lot easier work, so they would not come back to the construction industry.

This was, then, reflected in consumer complaints. We lose our good tradesmen due to the downturn of business, and we then are unable to build the same quality that we were able to build with our good tradesmen. We are, then, attacked for building a lousy product, when we really have no control over it.

Senator **Sarbanes**. Yes, you are put into a vicious cycle. You lose your skilled work force and then you get attacked because your product, in relationship to price, does not seem to provide value for dollar. But it is a situation that you have been forced into by circumstances which make it impossible to put together, and then keep on a sustained basis, a skilled, developed work force.

Mr. **Buscher**. You might relate it to a baseball situation, where the losing team that perpetually loses the games, they still go out and try to do their best, but they make mistakes in execution. They don't do it as well; they don't do it with as much enthusiasm. And pretty soon it is very hard to come back to winning ways.

Mr. Orlov, do you have any experience relative to employment?

Mr. **Orlov**. Yes.

I was in the downturn in 1968 and the one in 1974–75; and now this downturn, and I have seen what has happened to the quality of tradesmen. It has gone from good to very, very poor. The attitude of the tradesmen has changed completely, because he knows of these cycles. And as a result, we are attracting to the industry younger people in many instances, but who are just using us as a station until they find some other area to go into.

One thing is very noticeable now that I did not see as much of it in 1974-75 that I have seen now, that most of our subcontractors in the last 30 to 60 days were virtually hung up for dollars to make payroll. When we have a contract, we are supposed to be paid, as an example, on a 30-day period or whatever your arrangement might be. And I've had six or seven of these subcontractors call me on a Thursday or a Friday morning and say, "I know my money isn't due, but can you help me. I've got to make payroll. These people have to buy groceries."

I have noticed an intensity of this in the last, as I said, 2 months. This could be a serious thing. It could cause more people to go on unemployment, which, of course, is going to affect the State itself. And again, we will lose those trades that we need so desperately.

It is very difficult talking from an administrative standpoint to get a tradesman to train him to do things that are other than his hands, such as on a computer, so we can try to control costs and know where things are. And he takes days and months and years to explain to him the purpose of these things.

And then immediately, when you have cut back, he sees it very quickly and he is off into some other field—again with the loss of thousands of dollars, which must be picked up in the cost of the house, which must be picked up as an add-on which is going to increase the inflationary cost of the house.

Senator SARBANES. Gentlemen, you've been a very helpful panel. We appreciate you appearing before us and offering this testimony.

Mr. BUSCHER. Thank you, Senator.

Senator SARBANES. I think we will take Mr. Nathanson and Mr. Kaufman together, representing small business and the auto dealers.

Gentlemen, if you would come forward.

And the, Mr. Hendrix, we will take you.

And I understand Mr. King might appear to substitute for Mr. Yates. I don't know if he is here.

STATEMENT OF MITCHELL R. NATHANSON, PRESIDENT, MARINE PROPERTIES, INC., AND PRESIDENT, ANNE ARUNDEL MARINE TRADES ASSOCIATION, PASADENA, MD.

Mr. NATHANSON. My name is Mitchell R. Nathanson, and I am here to speak to you as an entrepreneur, investor, president of the Anne Arundel Marine Trades Association, and marina owner/operator in Anne Arundel County.

As an entrepreneur and investor, I have found it virtually impossible to become involved in a number of marine related business here in the county.

I have had no problem finding projects for sale at reasonable prices. The problem occurs when I work out the economics, either using banking financing or owner financing.

Even if I am fortunate enough to work out owner financing at favorable rates, I find that the cost of money to make improvements to update equipment and even for day-to-day operation is prohibitive. The number of clean projects available, ones not requiring improvement dollars, are virtually nonexistent.

As president of the Anne Arundel Marine Trades Association, I find out industry suffering greatly from the high interest rates. I am told that ours is the second largest industry in the State. When you begin to realize that a large portion of this industry is located here in Anne Arundel County, you can understand what effect this can have on the county as a whole.

Our industry is comprised of boat manufacturers, marine supply manufacturers, new boat dealers, yacht brokers, charter groups, sailing schools, marinas, marine supply stores, service people, engine repairs and replacements, and is further serviced by banks, restaurants, hardware stores, lumber yards, as well as other support services.

The high interest rates cause a severe ripple effect on the entire industry as well as the city of Annapolis, Anne Arundel County, and ultimately the State.

Let us first start with our boat dealers and yacht brokers. The high interest rates have caused a severe slump in new and used boat sales, causing a number of new boat dealers and brokers to go out of business. In my conversations with one of the larger banks, I am told that although loans are available for boat purchases, very few people are taking advantage of them. The new boat dealers who are able to hold on are doing so by laying off employees and cutting services. The floor planning costs have become a terrible burden. Dealers are finding themselves making marginal profits. The yacht brokers are in even worse condition because the rates are higher and terms shorter for used boats.

The slump in sales obviously affects the manufacturers and filters down to the marinas who now end up with vacant boat slips. This then causes economic havoc with the marina's ability to meet its debt service with revenues down.

A number of our marinas find themselves foregoing improvements, laying off personnel, and desperately trying to hold on by just barely making debt service payments. The ones who cannot survive end up selling at a loss in order to be able to sell at all.

In desparation, marina owner/operators are selling their marinas and leasing them back, thereby giving up their investment and control in order to continue to survive and make a living. We are also finding that a number of boat slip holders are selling their boats and getting out of boating to use the money to offset mortgages and their high interest rates.

These problems affect all aspects of the marine industry. As boat sales fall off and more and more people get out of boating, its affects slip tax revenues in the city of Annapolis and Anne Arundel County and continues to the State level by affecting registration fees paid to the Department of Natural Resources.

A number of people are under the impression that boating is a rich man's pastime. Statistics will show that it is not. Most of the people are in the working class with moderate incomes. The high interest rates affect them and the people involved in the marine industry most.

I thank you for the opportunity of appearing before you today and wish you good luck in your endeavors to roll back the extremely high interest rates which have become such a burden to so many of us.

Thank you.

Senator **SARBANES**. Thank you, sir, for a very thoughtful statement.

Mr. Kaufman, we will hear from you now.

STATEMENT OF STANLEY KAUFMAN, OWNER, CAPITAL MOTORS, AND PAST PRESIDENT, AUTOMOBILE TRADE ASSOCIATION OF MARYLAND, ANNAPOLIS, MD.

Mr. **KAUFMAN**. Senator Sarbanes, my name is Stan Kaufman. I own an automobile agency here in Annapolis, and I'm past president of the Automobile Trade Association of Maryland.

The new car automobile retail business in Maryland presently consists of approximately 375 new car dealers, down from 410 a year ago. These dealers employ about 18,000 people, down from 20,000 a year ago.

The dealers in Anne Arundel County, like all of the other dealers, are being adversely affected by the prevailing high interest rates. The cost of keeping cars in inventory and the increased costs of cars is making it more difficult for the cutomer to buy. Added to this is the high interest that the customer must pay for a consumer loan, if he can get one.

The end result is the dramatic decrease in sales over the past several years. The main factor for that is, of course, the monthly payments that a consumer must pay. For an average $8,500 car with $1,000, the payments with an APR of 12.67, which is the 7 percent add-on rate, is $212.20 a month. That same car now, if we can get if financed through our present finance companies, runs at an APR of 9.75—an add-on rate of 9.75 with an APR of 17.21, with a total monthly payment of $240.44, a $30 a month increase. While that may not sound like a lot, added to the cost of his home payments, his grocery payments, it just becomes unbearable for a consumer to buy.

The decrease in sales has resulted in higher inventories for dealers, less new car orders from factories, and ultimately layoffs of factory workers. It is the domino theory.

I cannot stock as many cars as I used to stock because my floor plan interest is so great. I now stock approximately $560,000 worth of automobiles with a floor plan bill of $11,000 a month. I used to store $1,300,000 worth of automobiles with a rate of about $8,000 a month.

I do not order cars from the factory. The factory can't produce. They layoff their production workers. Their suppliers have to lay off their production workers, which means that the people that they used to work for can't buy automobiles. It is again a vicious circle.

Another result of the high interest rates has been a lack of competition in consumer lending. Banks have virtually gotten out of consumer lending, and the captive credit companies are the only source. Only the more affluent customers can obtain financing, and thus the poor financial risks are unable to buy.

As in the real estate industry, automobile salesmen are now leaving jobs they have held for long periods of time. They are not looking for the pot of gold at the end of the rainbow. They just want to make a living.

As it has been said by the Governor and Mr. Porter previously, small businessmen are becoming embittered, and I mean good operators. My own dealership has been in operation for 20 years. From a dealership with a high of 42 employees approximately 18 months ago, I now have 26 employees, a drop of 40 percent.

When the then President Carter, prevailed upon the Small Business Administration to make SBA loans available for automobile dealers last October, I was fortunate enough to be one of the few—and I say "fortunate" at that time to obtain an SBA loan. I obtained a loan of $200,000 based upon a monthly repayment of $3,350 a month at an effective rate of 14 percent. I have just received my loan notice for this month. My interest alone is $3,833.35 with nothing on the principal with a negative balance.

You can't keep operating—good operators can't keep operating at this kind of deficit.

I thank you.

Senator **Sarbanes**. Thank you, sir.

I want to pick up on the very last statement you made about good operators because I think it is very important to get from you your perception of who is being pushed to the wall. It is often argued that the current policy simply shakes the marginal out. But we're receiving testimony to the contrary, and it is my own perception from the people who come to talk to me that this has gone muchs further. What has happened is that very high reputable, efficient, long-established people in the business simply cannot cope with this situation.

How do you see that?

Mr. **Kaufman**. Senator Sarbanes, I can only blow my own horn. I happened to be honored by the National Automobile Dealers Association last year. There are 70 dealers in the United States who won Time Magazine Quality Dealer Awards. I was the winner—1 of 70 in the Nation.

This year Sports Illustrated picked 26 imported car dealers out of 4,000 to win their Dealer of Distinction Award. I was 1 of those 26 honored.

I am a good operator. But I cannot buck the interest rates that I am carrying now. I am paying two points over prime as of yesterday, or 22 percent, for floor plan. You can't carry inventory, and you can't make a decent sale because the average $8,000 car would cost you $150 a month to carry.

I noticed in the paper today that one of the oldest and best operated Datsun dealers in the city of Baltimore was sold yesterday. I happen to know him personally. It's not a question that he wasn't making any money; it was a question that the return on his investment wasn't good enough.

A Toyoto dealer in Baltimore, again an import dealer who is supposed to be making good money, was sold the day before yesterday to another large General Motors dealer. These are the people who are being backed up against the wall—the smaller good operator.

Senator **Sarbanes**. The point you make I think is very important. We had Jerry Stautberg before us yesterday, and he made the point that one of two things is happening. Very good people who want to stay in the business are being pushed very hard. As in your own instance and many comparble instances, very good people get out of the business not because they are actually forced to get out of the business. They are good and skillful enough to handle the situation, but they look at it and say, "Well, why not just liquidate my investment, and put it out into these high interest paying securities that are floating around? Why go through all of the trouble and hassle to be an economically productive and viable person?" I think you are getting both of those things at work.

Mr. **Kaufman**. Senator, it used to be that a 2.2-percent return on your investment as an automobile dealer was a good net return. The average return now is 0.9 to 1.1 on your investment. It is awful hard not to take the money that you can get for a dealership and put it out on a 5-year Treasury bill that was sold the other day for 16.2 percent.

Senator **Sarbanes**. And then do nothing.

Mr. **Kaufman**. Do nothing. Maybe just sit there, work a couple of days a week selling automobiles—I don't know—but it's very enticing.

Senator **Sarbanes**. Mr. Nathanson, what is the situation in your area, in terms of who is being squeezed and in terms of their effectiveness and efficiency?

Mr. **Nathanson**. I think the ones that may have been marginal operators probably have gotten out over the last year or so. I think they have been forced out. I have looked at a number of marinas myself that it just wasn't economically feasible to buy. There was no way that you could make a profit.

The people that are buying marinas of this type are investors, high dollar investors that are looking for tax writeoffs, and they can afford and want the kind of loss that they are going to get from them. But these marinas are not being improved. They are just being taken pretty much as they are, and they are operated by these people.

The people who do reasonably good jobs managing marinas are faced with pretty much the same problems that everyone else is faced with. If you want to make any kind of improvements and you don't have the cash flow, it is virtually impossible to get money from a bank or any kind of a lending institution where it's going to make any sense. So we are almost at a point where we are just stagnant; we're dormant; we're just trying to stay alive at this point, hoping that things will get better.

Senator **Sarbanes**. We had testimony yesterday from a small businessman who said he had the money to make improvements but he looked at the situation, and calculated that it would be better for him to take the money and put it into high-yielding securities rather than to invest it in making his business more efficient and productive. He doesn't even have to go to seek the credit; he's in the position to make the investment, and his decision is being made on the basis of the comparison between what the investment will produce in his business and what he can get by simply putting it into the money markets.

Well, gentlemen, thank you very much. You've been a very helpful panel, and we appreciate your testimony.

I want to recognize that Delegate Pauline Menes of Prince Georges County, has been with us. Pauline, we are pleased to have you here. And I think I see Delegate Julian Delfey here with us, too.

Mr. Hendrix, you have been very patient, and we appreciate it. I don't think Alan King was able to make it, so we will go ahead and take your testimony, sir.

STATEMENT OF C. OTIS HENDRIX, PRESIDENT AND TREASURER, FORT MEADE CREDIT UNION, FORT MEADE, MD., ACCOMPANIED BY MATTIE KIRK

Mr. **Hendrix**. Thank you, Senator Sarbanes.

I would like to say that it is quite refreshing to note that some of our representatives of our government are, if you will, taking an interest in this interest situation which we are facing.

I represent the Fort Meade Credit Union and was asked to come down also on behalf of the Maryland Credit Union League, representing our credit union. I have with me today my right hand, who happens to be on my left hand, Mattie Kirk, who is the vice president of our credit union and also has the direct responsibility for collections and liaison with those collection companies that Commissioner Fell spoke of earlier.

Credit unions are faced with three problems as I see it: inflation, legislation, and regulation. All three, of course, have a direct effect on the cost of doing business. In our case, it directly affects the rate of interest which we must fix on our loans.

The principal area, as we see it, is inflation, brought about by the high interest rates, which directly affects the delivery of our services—our services, of course, being lending money. It has become very difficult to continue to make, at reasonable rate, loans to those individuals who have a need to borrow. Consequently, with the advent of the money market certificates, ready asset account, and the like, depositors have become more rate-conscious and interest-wise.

The loyal members of the credit unions that we have known for years who have saved regularly at our credit union for many years are dwindling away in favor of the higher paying money market certificates, Treasury Bills, and so forth. The Federal Government is a tough competitor for business—businesses such as credit unions, savings and loans, who must compete for those funds.

The interest being paid on savings now determines where the member will save. Consequently in order for us to hold the larger depositors and have funds available to loan to persons with the need to borrow, we must offer higher yields than other institutions. If you want to keep the funds you have on deposit and to attract new depositors, you must offer the better rate.

We all know if no one saves, no one borrows. We have noted that some institutions have been offering auto loans at extended terms up to 60 months in order for the payments to be low enough for the borrower not to become overextended.

Let's consider what we have when the car becomes 5 years old with 50,000 to 70,000 miles. As a rule, you have a worn-out 5-year-old car worth about one-tenth of the purchase price that we invested in it 5 years prior or during the term of the loan—I think we can all agree, a rather poor investment.

Just a few years ago, 2- and 3-year term loans for a car were commonplace. Now they are a rare exception. I noted recently that one dealer was talking about automobile mortgages. There is an article that appeared in the News American, dated July 27, in which someone talk about there might be a need to have points for purchasing automobiles and financing them. For an example, this article indicated that on a $7,000 loan, an up-front point of $140 may be required.

While it may mean little now, it should be a sounding board to what the future shock could hold for us if we do not get this interest situation under control. As you can imagine, starting out with a 16-percent loan and having it bumped up to 18, 19, or even 20 percent before you get it paid for—I hope this will not be the case, but with the past conditions, I would not rule it out.

Someone said that the financial industry was one of the most regulated businesses in our country. I'm not sure about the accuracy of this statement; however, I can speak for credit unions. We are flooded with regulations of all descriptions, telling us how to do it better but not necessarily for less. Numerous regulations for consumer protection continue to offer or continue to pile up, often changing what we already have in effect. Some added requirements are always expected.

All of these add to the cost of making loans, thus increasing the rate. As you know, along with the increased protection must come some increased costs in the form of expenses to operate and to stay in business, complying with these various rules and regulations. And, yes, the various one-time reports which we must also respond to.

Included in this increased cost is additional staff employees who must continually review, interpret, implement, and insure compliance. Sooner or later, the cost to implement more and more regulations and changes results in higher cost to the consumer—in our case, member depositors and borrowers. With firms who lend money, it means simply increased interest rates, reduced savings rates, or a reduction in services.

It may in fact mean all of the above. Most assuredly, it means an increase in the rate of interest that we must charge for our loans.

In my judgment, the legislation which most affects all lending institutions is the 1980 Deregulation Monetary Control Act. In this regard, the phasing out of regulation Q has caused lenders to pay more for depositors, thus boosting the rates which must be fixed for their services and their loans. The higher rates are required to pay the depositors for their savings. As such, all lending institutions are competing for deposits by paying more to savers.

In this regard, we are competing with the local banks, savings and loans, and much to our chargin, sometimes we are competing with other credit unions in this maze to attract the depositor.

The cost of services, including the compliance with the regulations which we spoke to earlier, will in our judgment not soon disappear. The higher cost must be absorbed in some manner, thus higher interest rates. In costing our services, we must charge more for loans because this is the service which generates our income which we use for additional loans, expenses, and regulatory reserves.

The net return on loans is directly affected by the cost of making the loan and servicing it during the term. The rate, of course, will vary with the size of the material. Of great importance to the rate, of course, is the loan losses which must be allowed for in fixing the rates of interest charged for loans. Cost accounting for our loans has become a very serious matter, and we are very concerned with the rate we set. Foremost we must consider when setting the rate how much we must generate to pay their shareholders a respectable and competitive return for their deposits without which we would have no funds to set lending rates for.

This respectable rate is not necessarily to attract new depositors, but of equal importance, it is to hold those whom we have. Thus we are required to alter our rates, depending upon the demands.

That concludes, Senator Sarbanes, my statement. I have 10 copies that I am prepared to leave with your staff, sir. In addition to that, I would be delighted to respond to any questions that you may have.

Senator **Sarbanes**. Mr. Hendrix, thank you. That was a very comprehensive statement. I think it was a very good analysis and summary of the problems confronting the credit unions.

I really only have one question, and that is to ask you, representing the Maryland association, how many of your depositors are going elsewhere to seek a higher return in the present climate and to what extent they are sticking with you out of loyalty, convenience, habit, and so forth.

Mr. **Hendrix**. Well, Senator, I suppose loyalty can pass with even higher rates. Just for an example, I learned today as I was leaving, we keep a close watch on the 26-week money market certificate, and I observed that it was posted at 14 plus percent today. Those loyal depositors and members that we have had over the years must quickly take a look at what they are receiving from us. And in the case of the Fort Meade Credit Union, we are paying 12 percent on individual savings accounts, which we consider to be rather respectable. But when there is a difference of 4 to 6 percent on an individual's deposit, I cannot blame them when one of our large depositors comes to me, for an example, and says, "Look, I've got $40,000 that's lying here in the Fort Meade Credit Union that I'm drawing 12 percent on, and I can just walk next door"—and we happen to share office space with one of the local banks—"and in the same building I can move next door and get 16 percent or 4 percent more than you are paying."

We have quite a bit of that. Traditionally, our smaller depositors, who are the ones that have a repeated need to borrow, stay with us because perhaps our lending practices might be less restraining than some of the other institutions, whereby the larger depositors, who are the ones that we need to attract and hold, their loyalty starts slipping away.

Senator **Sarbanes**. Thank you very much, sir. As you know, I have worked very closely with the credit union movement, and I look forward to continuing to do so. It has been very helpful to have your testimony, and we appreciate your patience in staying with us this morning.

Thank you very much.

Mr. **Hendrix**. Thank you, Senator Sarbanes.

Senator **Sarbanes**. The subcommittee is recessed, until 2 p.m., where we will reconvene at Wye Mills, Md.

[Whereupon, at 12 p.m., the subcommittee recessed, to reconvene at 2:05 p.m. the same day.]

AFTERNOON SESSION

The subcommittee met, pursuant to recess, at 2:05 p.m., in room H117, Kent Humanities Building, Chesapeake Community College, Wye Mills, Md. Hon. Paul S. Sarbanes (member of the subcommittee) presiding.

Present: Senator Sarbanes.

Also present: James K. Galbraith, executive director; William R. Buechner, professional staff member; and Betty Maddox, assistant director for administration.

Opening Statement of Senator Sarbanes, Presiding

Senator **Sarbanes**. I think we will go ahead and get started.

First, I want to thank President Schleiger and the Community College for their hospitality. We are pleased to be here, and I think it is appropriate that a hearing of this sort should be held here at the Chesapeake Community College. I know of its own deep involvement in the community, and I hope that this hearing helps to deepen and intensify that relationship.

This is the second day of hearings that the Subcommittee on Investment, Jobs, and Prices of the Joint Economic Committee is conducting to examine and document the effects of high interest rates on Maryland communities and on Maryland citizens.

Yesterday we heard graphic examples from a wide range of business and local leaders, concerning how high interest rates have hurt the local economy in Baltimore County. This morning we held hearings in Annapolis, and we were fortunate enough to have the Governor as the first witness. This afternoon at Wye Mills on the Eastern Shore and are looking forward to the panels that will be testifying very shortly.

In the course of 6 separate hearings this week, the subcommittee will hear from more than 80 witnesses, about the severe challenge of high interest rates—a challenge which the witnesses know best, since they face it daily in their own economic activities.

It is no exaggeration to say that the problems created by continuing high interest rates are approaching crisis proportions. The situation this year, with the prime rate remaining over 17.5 percent, is unparalleled. In the last 12 months, the prime has been as high as 21.5 percent, and today it remains at 20 percent. The mortgage rate any many financial institutions is over 17 percent, the highest it has ever been. The interest rate on tax-free municipal bonds is now over 11 percent, twice what local governments had to pay only 4 years ago.

These rates have created grave obstacles to the operations of many established and productive enterprises, particularly in those sectors of the economy which depend upon a line of credit. The damage thus far is serious and, if conditions are not soon improved, will be irreparable. Enterprises which have been an important asset to their respective communities, an important economic resource, will be lost.

The burden of high interest rates has become a major financial problem for small businesses. Auto dealers, farm equipment dealers, and other sellers of consumer durables have been particularly hit. For the first time in the history of a quarterly survey by the National Federation of Independent Businesses, small businesses rank interest rates and financing as the single most important problem facing them. The survey, which was released last week, says: "The currently high rates of interest are making a bad situation unbearable for many small firms."

Last year, almost 12,000 businesses failed nationwide, the highest figure in more than a decade and almost double the number of failures in 1978, when interest rates were only half their current level.

The situation is particularly critical in the home building industry. Housing starts last month stood at an annual adjusted rate of just over 1 million, down 17 percent from the already-reduced pace of a year ago, and only half the 2 million starts needed to meet nationwide demand. Construction-related business is similarly depressed. Unemployment in the construction industry is running at 15 percent, more than twice the industrial average. Home sales have fallen dramatically, down in Maryland as much as one-third from the levels of 2 years ago.

Financial institutions, particularly savings and loan associations, which have done so much to make home ownership a reality, face unprecedented pressure. High interest rates have also had serious implications for the finances of State and local governments.

As a Sunday's New York Times article commented:

> These are dark days for State and local treasuries * * * Prices of municipal bonds have been sliding all year and fell to a historic low last week. At the same time, the interest rates that governments have to pay on their new bonds have reached historic highs.

This is an especially serious blow at a time when State and local jurisdictions must look forward to sharp reductions in financial support from the Federal Government.

The Federal Reserve Bank in Richmond reports that Maryland farmers are now paying the highest interest rate they have ever had to pay for bank loans, with many farmers paying 2 percentage points above the current prime rate. As a result, farmers across the State, as elsewhere in the Nation, have been postponing or abandoning productive investments which would make them more efficient and effective producers.

The purpose of these hearings is to document across the State, with testimony from those directly affected, the conditions to which these statistics attest. Over the past 18 months, the Joint Economic Committee, created by the Employment Act of 1946 to provide Congress with economic information and advice, has held a number of hearings on the interest rate question, and will undoubtedly return to this matter when the committee, in the fall, begins its examination of the impact of the recently enacted economic program.

It is my hope and expectation that the record of the Maryland experience established by these hearings will make an important contribution to the committee's work and to the response which policymakers must undertake to remedy this pressing economic situation.

With that by way of opening, I think we will go to our first panel. We have three outstanding representatives of the farm community here: Fred Hubbard, Roger Richardson, and Henry Spies.

Gentlemen, if you would come on down here in front, we are prepared to hear from you and have the benefit of your experinece.

Do you have a preference yourselves as to how you proceed.

Mr. **Richardson**. He's older than I, so I will defer to him.

Senator **Sarbanes**. That sounds like the Congress of the United States. We would be pleased to hear from you.

STATEMENT OF HENRY A. SPIES, JR., CORDOVA, MD.

Mr. **Spies**. Senator Sarbanes, agriculture is the Nation's biggest industry. It has assets of a total of $927 billion. Agriculture is the Nation's largest employer. It employs between 14 and 17 million people, producing food and fiber for the supermarkets.

The American people need a plentiful food supply——

A **Voice From Audience**. Could you speak a little louder, please?

Mr. **Spies**. The American people are blessed with a plentiful food supply, and envied by all other peoples in the world. The American consumer will spend an estimated $275 billion in 1981 for farm-produced food, of which the farmers will receive an estimated $75 billion. The remaining $200 billion will be spent on assembling, inspecting, grading, storing, processing, packaging, wholesaling, and retailing.

The American farmer is the most efficient producer on Earth. One farm worker now supplies enough food and fiber for 70 people, compared to 45 people, only 10 years ago. During this same period of time, productivity per man has declined in many industrial segments of our economy.

Agricultural products represent the number one export for the United States in the sensitive world balance of trade arena, with over $40 billion of agricultural products exported in 1980. This equals to 1 cropland acre out of 3 that goes overseas.

Farmers are consumers, too. Last year, they spent $55.2 billion for machinery and equipment, fuel and vehicle maintenance, feed and seed, and fertilizer and lime.

American agriculture producing to feed the world is a Cinderella story unequalled in the history of mankind. However, the beautiful fairy tale has reached its midnight bewitching hour. The future of agriculture and the foundation of the American farm family is in serious jeopardy.

There are danger signals that cannot be ignored. No longer can one segment of society be called upon to carry a burden of responsibility that will determine the survival of a society, against such overwhelming odds as those that face the American farmer today.

Secretary of Agriculture Block reported in early August that net farm income dropped almost 40 percent from 1979 to 1980, and pointed out that condition won't get much better until "we can get a handle on inflation and interest rates."

Using corn as an example of how inflation rates have increased production costs, in 1978 the U.S. coverage cost of production per acre was $199.20, compared to $232.33 in 1979, $277.83 in 1980, and a projected cost of $320.47 in 1981. During this same period of time, we find that the average price received per bushel of corn in 1978 by all Maryland farmers was $2.38. With the 1981 harvest season only 2 weeks away, it is doubtful that local farmers will receive $2.38 per bushel for 15.5 percent moisture corn delivered to the elevator.

With an anticipated average yield in Talbot County of 100 bushels per acre, the question becomes not how much the farmer will make, but rather how little he will lose. The depressed cash grain price structure can only lead to a speculative question: Does the U.S. Government have an unwritten cheap food policy in operation that is related to their foreign policy strategy?

Machinery ownership costs are primarily determined by prices of machinery and by interest rates. Increases in both of these items caused machinery ownership costs to rise by more than 20 percent in 1980, with an additional projected increase of 14 percent in 1981.

Costs for fuel and lubrication rose by 37 percent between 1979 and 1980, and are projected to increase by an additional 24 percent in 1981. Other production costs input price changes projected to increase in 1981 are: Farm motor supplies, 13 percent; fertilizer, 14 percent; tractor and machinery, 11 percent; agricultural chemicals, 12 percent; seed, 10 percent; and farm real estate value, 12 percent.

Farmers electing to store cash grains will find that interest costs will nearly equal the storage and insurance costs. In 1978, the average interest cost per acre of corn was $3.15, compared to $4.27 in 1979, $6.31 in 1980, and projected to $7.28 in 1981.

A neighboring farmer reported to me that his annual interest costs above principal have increased by $40,000 since April 1978.

Other farmers are reporting that their annual interest rate payments exceed the amount paid on the principal of the loan.

High interest rates soaring to the 20-percent level are the result of deficit spending by the Federal Government. Not until the Government stops borrowing money to cover the deficit budget will the necessary relief be realized from high interest rates and spiraling inflation costs.

Locally, many farmers have suffered under the chapter 11 bankruptcy law. Grain elevator operators, under this bankruptcy law, have put producers in a holding pattern where payment for their grain is tied up for 2 or 3 years. With the high interest rates, this becomes a double loss for the producer to provide the needed protection for the farmer. This law must be completely revised.

It is true that the recent session of Congress did provide some tax relief for farmers—in reduced income tax rates, capital gains taxes, and estate taxes. However, the young aspiring farmer today is much like his counterpart was during the 1930's, when he only had two alternatives of how to become a farmer: One, he could inherit a farm. Second, he could try to marry a farm.

However, in the 1930's land was cheap, but the young farmer had no money. Today he still cannot afford to buy a farm. The price of land is too high, interest rates are too high, and the profit margin is too low.

If the American farmer is to continue to supply the breadbasket for the world, he must have some relief from these profit pressures. He cannot exist with high inflation and high interest rates and sell his products at the same time on a continued flat market.

Never has management decisions been more important to the farmer than they are today. Farmers must decide what to produce, which production method to use, how much of each commodity to produce, when to buy and sell, and where to buy and sell.

As an example, some farmers who have used their marketing tools skillfully, even this year sold forward cash contracts and hedged to realize a market price of $3.50 per bushel for corn and over $8 per bushel for soybeans. Managerial decisions made to solve past problems are not necessarily the proper decisions to solve today's problems.

Many have asked the question: Is the American farmer secretly going broke?

The response by the farmer: Heck, no, the whole town knows I'm going broke.

Thank you.

Senator SARBANES. Roger, I think we will hear from you now.

TESTIMONY OF ROGER RICHARDSON, EDEN, MD.

Mr. RICHARDSON. Thank you, Senator.

The farm where we live has been in our family for six generations. I started farming with my father in 1950. We had 75 acres. We are now operating 1,500 acres in Sommerset, Worcester, and Wicomico Counties.

There are two or three things I wanted to point out, and I will be very brief.

In 1971, we purchased the farm. It took 11 bushels of corn per acres to pay the interest. Last year, we purchased another farm. It took 57 bushels of corn per acre to pay the interest. This year, there was a farm sold in our same area, and it is going to take 97.5 bushels of corn per acre just to pay the interest. I'm not talking about the payment; that's just the interest.

In the same area, on soybeans, in 1971, it would take 6.5 bushels of beans per acre to pay your interest. In 1980, 26 bushels of soybeans. In 1981, 38 per acre. And down here, when you get much over 40 bushels of beans, you have done a pretty good job of farming.

Your growing costs, particularly for interest: In 1980, it cost $21.07 per acre on our farm to operate, for the interest cost of growing the crop. In 1981, it is going to be $40.88; that is $65 more per acre in cost, as well as your high interest cost.

The land costs in 1971 were certainly lower. Today, you're talking about five, six, or seven times the cost of land. But also, this comes back to the farmer, because his interest is paid on what he had to pay for the land. And there is nobody that can farm without land.

Another area that's going to concern a lot of us—a lot of your small farm supply businesses are going to have to go out of business, and are going out of business, because of interest costs. Pocomoke Farm Supply in Pocomoke City, Md., is closing this month because they have been losing $500 a week and paying 22 percent interest, and they no longer can afford to do so.

This is going to cause some of the area farmers—instead of driving 3 or 4 miles to get their supplies, they have to go 25 miles.

In any agricultural area—be it the Eastern Shore, the Midwest—if agribusiness prospers, the general economy does as well; if not, all suffer together.

If I hadn't started farming when I did, with my father, and with his help, I would not be farming today. My point here is that today it is nearly impossible for young people to get into farming in any way, because of the tremendous cost. And the biggest cost of this is probably interest.

On our farm in 1971, we were operating about 1,200 acres at that time. We had a $6,000 interest bill; in 1981, we are going to be paying about $44,000 in interest.

That's all I have to say.

Senator **Sarbanes**. That is a pretty definitive statement.

I think if you could sketch out for us the reliance of farmers on a line of credit, and how the interest impacts on them, that would be helpful. Could you do that a bit?

Mr. **Richardson**. Senator, there are several ways that interest impacts on us.

A few years back, we would buy our ingredients to grow the crop—fertilizer, seed, and so forth—and the supplier would carry you until crop time, many times without any interest. Now, within a 2-week period after you get your fertilizer, you get a bill; and on the bottom of that it says, "1.5 percent per month."

Also, with some of our lending institutions, we have a rather substantial line of credit. But in the last 2 months, we've started getting bills, monthly, for the interest. Now with agriculture, that is sort of a little bit of a pain in the neck and also the pocketbook. But when you have to pay interest by the month on the farm, you have got to go borrow the money to pay the interest. Where in the past, when you had a demand note, you could borrow the money and pay the interest when you paid the note off. This is one of our big problems.

Senator **Sarbanes**. How recent is that change in practice?

Mr. **Richardson**. We paid one by the month now. Last July was the only month that we have been billed that way, but they told me that from now on, it will be monthly.

Senator **Sarbanes**. And that began when? Just now?

Mr. **Richardson**. In July.

Senator **Sarbanes**. What about the practice of your suppliers?

Mr. **Richardson**. Well, that began about 2 or 3 years ago, but it is an added cost to us, because now we have to have the money to pay the bill. A farmer normally has his money in the fall, and the rest of the year is broke.

Senator **Sarbanes**. Ordinarily, with your suppliers and the lending institutions, they would let it run for that period. Is that correct?

Mr. **Richardson**. Right.

Senator **Sarbanes**. And they have both stopped doing that?

Mr. **Richardson**. Well, they had to, I mean, they're caught in the same pinch as we are.

Senator SARBANES. But they are, in effect, passing it along?

Mr. RICHARDSON. We don't have anybody to pass it to.

Senator SARBANES. That's right.

Do you recall a period when you faced higher interest rates than you face now?

Mr. SPIES. No. And I think that has something to do with the price of grain, too. The first man we sell to, he has to go borrow money at 1 to 1.5 percent above prime. He has to take it off from us, and the next man the same way. I mean, why buy grain at the high interest rates when they don't have to? Let us farmers hold on to it, or keep the price down.

Senator SARBANES. What is the current interest rate that farmers in the area are facing?

Mr. RICHARDSON. Right now we're paying 18 percent.

Senator SARBANES. How do you think the current interest rate has affected the farmer's willingness and ability to invest in new machinery and new buildings, and so forth?

Do you have any observations on that subject?

Mr. RICHARDSON. They have a lot of interest in doing this, but they can't afford to do it because there is just no way that any business can survive with 18 percent interest.

Mr. SPIES. The increase in interest has taken away or livelihood. That is what we were living on. If you could borrow money for 8 percent, you figured on your investment to make 8 percent above that, and that's what you lived on. You can't do it now. There's no way. There's no way.

Senator SARBANES. We had a small businessman who testified yesterday to an interesting impact of the interest rates. He said even with the money to make a productive investment in his business—in other words, he was fortunate enough not to be confronted with the situation of having to go out and borrow in order to expand—even so, he was considering whether it wasn't better simply to take his money and invest it in the highest yield securities around that he could find rather than put that money into his business, because he didn't think he was going to get as good a return on his business investment, even though it would make him more efficient and more productive, than he could get by putting it into these high-yielding funds.

Mr. RICHARDSON. I'm sure Hank will agree with me, we would both be much better off if we had our net worth, our value, in CD's today than we would in farms.

Mr. SPIES. You know, going back even to 1980, it cost $277 to plant a crop of corn. And in Talbot County, our average is 100 bushels. And by the time you put this interest rate on top of that, it's just to much.

Senator SARBANES. Are you acquainted with any farmers who have really had to give up their businesses because of the high interest rates?

Mr. RICHARDSON. Paul, I think you're going to see that next year. Most of the lending institutions are going through this winter with them; but I think next year you're going too see some of the men weeded out from the boys.

Senator SARBANES. Let me ask this question. We had testimony from some auto dealers which makes clear that even the very best run, most efficient people, who have been in the business a long time, are not able to handle the current situation. In other words, it has gone well beyond where you say, well, it is a marginal operator or someone who was undercapitalized and wasn't very efficient and didn't administer his business well.

In fact, we had testimony this morning from an auto dealer in Annapolis who, for the last 3 years running, has gotten national awards for being one of the best auto dealers in the country. He says he's now in a situation where he can't handle what he is up against.

Do you see the same thing within the farm community—that it is really reaching established operators, very efficient and very effective? Who are affected?

In other words, is it accurate to say that you can't pin the responsibility for their plight on their weakness? These are good, established, efficient operators.

Mr. Spies. You take a farmer—that is probably paid for. He's not updating his procedures. He's waiting to retire. He will be farming next year. He won't make any money, but he'll be farming. All the young fellows that have machinery payments to make, and even the ones that bought a little bit of land—it doesn't take too much to find out that the production is costing more than you're receiving and you just can't do it, that's all. And when we stop buying, everybody stops working.

Senator Sarbanes. Is there an opportunity for young people to get into farming nowadays?

To the extent there isn't, how much of that is attributable to the interest rate?

Mr. Richardson. As Hank said a while ago, you can either marry into it or get born into it. As far as a young farmer starting out today, the odds are 99 to 1 against him.

Mr. Spies. There's a lot of land moving around, but it is outside people coming in here, buying. Not many local young boys are buying their farms around here.

Mr. Richardson. It is a double-edged sword that we are working against, with inflation the way it is. We are dealing with more money every year, and the interest is higher all the time. It takes more money to operate and you have to pay more interest. The thing we're doing is, we're paying the interest instead of getting some of the other necessities that we sometimes need to be more efficient.

Senator Sarbanes. Well, gentlemen, you're been very helpful, and we appreciate you willingness to come today and give us the benefit of your own experience and observations.

I think I would be remiss if I didn't take just a moment to acknowledge the very fine service that Roger Richardson has rendered not only to the farm community of this State, but to the entire State, over the last 4 years, as a member of the ACSC committee. I know the time and energy and effort that he gave to that work.

We all owe a debt of gratitude to you, for really being willing to perform that public service. It is not always appreciated on occasion, and I thought I ought to acknowledge it here today.

Mr. Richardson. Thank you.

Senator **Sarbanes**. Thank you all very much. We appreciate your coming.

Mr. Boren, I think we might take you next, as the general manager of the Federal Land Bank Association. I think that might fit in right here.

STATEMENT OF JOEL A. BOREN, GENERAL MANAGER AND CHIEF EXECUTIVE OFFICER, MARVA PRODUCTION CREDIT ASSOCIATION AND THE FEDERAL LAND BANK ASSOCIATION OF SALISBURY, SALISBURY, MD.

Mr. **Boren**. Mr. Chairman, my name is Joel A. Boren. I am general manager and chief executive officer of Marva Production Credit Association and the Federal Land Bank Association of Salisbury. Our associations are a part of the Second Farm Credit District.

The cooperative Farm Credit System is composed of federally chartered instrumentalities which operate under authorities granted in the Farm Credit Act of 1971, Public Law 92-181, and other statutes, most recently the Farm Credit Act Amendments of 1980, Public Law 96-592.

The Farm Credit System is the largest single source of credit to American agriculture. As of April 30, 1981, the System had $72.5 billion in loans outstanding—a growth of 14.8 percent over the previous year.

The U.S. Government provided the initial funding for the various institutions of the Farm Credit System. This seed money has since been repaid. The Farm Credit System is now entirely borrower owned and controlled.

The System provides its loan funds primarily through the sale of securities in the national and international money markets. These securities, which are sold through the System's fiscal agent in New York City, are not guaranteed by the U.S. Government.

Now to proceed with the issue and how it affects Delmarva.

The Delmarva farmer, as well as other farmers throughout the country, over the past 5 years, have seen interest rates soar from short-term, operating-type loans in January 1976 of 8½ percent to the present level of 16.5 percent. There was a time in mid-1977, May through August, when interest rates for operating dropped to 7½ percent.

Mortgage funds were 9 percent in January 1976 and now are at a level of 13 percent plus a 5-percent loan service fee. These interest rates I have quoted are for the Marva Production Credit Association and the Federal Land Bank Association of Salisbury, which serve Wicomico, Worcester, Somerset, and the two Eastern Shore counties of Virginia, Northampton and Accomack.

Loans that were made in 1976 with cashflow projections using those interest rates have been through some rough times and still may have rougher times yet ahead.

All areas of the agricultural community have experienced increased production costs, while gross income has not increased proportionately. This means a reduction in net funds available to service increased debt and living expenses.

Many farmers in our area have fought back in many ways:

Reduced amount of fertilizer and chemicals used. This can be done for a year or so, but detrimental effects will be noted if this practice is continued for an extended period.

The ideal of being debt-free, not owing anyone, is now a thing of the past. Farmers must now schedule payments they can meet, which means longer term loans.

The selling off of timber and applying proceeds to debt. Timber does not grow at a rate that will offset interest rates.

Tenant-occupied farm dwellings are sold off, and the proceeds are applied toward debt. This is one method of lowering average per acre costs.

Land costing $2,000 per acre cannot provide net income to cover ownership cost of growing corn, soybeans, or other small grain. A farmer can only afford this high-priced acreage if his existing land is at a lower price per acre, thus lowering his overall average land cost.

The cost of production of one farm commodity I will cover will be the cost of corn in 1976; $148 an acre was what the cost of corn was. This does not include the cost of owning the land, nor does it include the interest rates. If you paid cash for everything that went into the ground to produce that acre of corn, it will cost you $148 an acre.

In 1981, the price was to $188 an acre, a 22-percent increase.

The average price for corn in 1976 per bushel was $2.55.

As of the Wall Street Journal, the September futures is $2.91, an increase of 13 percent.

If you add the cost of interest rate to the cost of production, the increase will increase from 22 percent to 76 percent. This is a 54-percent increase in interest cost. The average farmer cannot afford this increase in interest cost while the increase for goods and products does not rise accordingly.

Thank you.

Senator **Sarbanes**. Well, thank you very much, Mr. Boren.

Let me run through that last example you've given now.

You say that in 1976 the cost of corn per acre was $148, assuming no borrowing in any part of the production; is that right?

Mr. **Boren**. Absolutely. And the cost of land is not included in that.

Senator **Sarbanes**. You're assuming they have the land?

Mr. **Boren**. Right. If you rent the land, you could add $60 an acre to the $148.

Senator **Sarbanes**. And then you say that—for what year was $188.

Mr. **Boren**. The $60 an acre in 1981 would compare, I would say—it probably would be $10 or $15 rent per acre in 1976.

In 1981, you're looking at a $60-per-acre cost, so you would add $60 per acre, and come out with $248 per acre being the cost of corn if you add your land rent.

Senator **Sarbanes**. Compared with $158 to $163 in 1976?

Mr. **Boren**. Right.

Senator **Sarbanes**. And that is all assuming no borrowing and no interest cost?

Mr. **Boren**. Right. If you add that, you've got a 54-percent increase in that period of time.

Senator **SARBANES**. Do you have any figures on what percentage of the farmers can operate on the first example you offered, which is without carrying any interest cost?

Mr. **BOREN**. Zero. I would say in today's economy it would be zero.

Senator **SARBANES**. How about in 1976?

Mr. **BOREN**. Probably 10 to 20 percent could operate in 1976, maybe without borrowing any money.

Senator **SARBANES**. 10 to 20 percent in 1976?

Mr. **BOREN**. Yes.

Senator **SARBANES**. Now you're saying there wouldn't be any that could do that?

Mr. **BOREN**. No.

Senator **SARBANES**. What about failures? What is your experience or observation on that?

Mr. **BOREN**. Right now the associations have more chapter 11, chapter 7, and chapter 13 bankruptcies than we've ever had in our history. We have more foreclosures than we've ever had.

Senator **SARBANES**. By what order of magnitude?

Mr. **BOREN**. It is substantially more. We're looking at, right now, chapter 11's and chapter 7's. We had none in 1979 or 1980, and we have them in 1981 as a percentage.

Senator **SARBANES**. So, in a sense, it is a new development that is confronting you?

Mr. **BOREN**. It is a completely new development.

Senator **SARBANES**. Are these problems hitting what you would characterize as the marginal operator, or have they started to hit more established people?

Mr. **BOREN**. At the present time, it is the marginal operator, but it is only a matter of time until it goes to the better operator because of interest rates.

Senator **SARBANES**. Do you have any sense of the interest rate at which established people might be able to carry on business without being subjected to today's extraordinary pressure that this creates?

I know the lower the better, obviously. But in what range, if interest rates would get there, could at least more people, or a substantial number, say, "Well, this is tough. But we can continue to operate with this while other problems are being addressed"? Do you have any sense of that?

Mr. **BOREN**. Twelve to fourteen would probably be reasonable—that is, for funds used in the operation. And 10 to 12 would probably be a good number for the fixed assets, such as land.

Senator **SARBANES**. You're distinguishing there between short-term operation and the long-term investment; right?

Mr. **BOREN**. Yes.

Senator **SARBANES**. Do you see people moving to sell because of these high interest rates—trying to get out of the business and liquidating their capital investment?

Mr. **BOREN**. We are seeing some farmers, who would not ordinarily sell off sections of farms or lots, today go out and sell those lots in order to try to capitalize some of their past losses. We are seeing them cut timber today, which is a last effort so to speak, to try to lower their initial investment in the property.

Senator **Sarbanes**. In those instances where do they sell off, whom are they selling to, do you know?

Mr. **Boren**. Most of the time, investors or speculators.

Senator **Sarbanes**. Speculators?

Mr. **Boren**. Yes; a farmer sells a 20- or 25-acre tract to somebody who is going to go in there and subdivide or put roads in there or something and to develop it into a rural community.

Senator **Sarbanes**. Well, thank you very much. We appreciate your testimony. It has been very helpful.

We'll next hear from Mr. MacGlashan.

And maybe, Mr. MacGlashan, we will take the auto dealers at the same time, in a panel with you, if that is all right.

So, if we could have Patrick Cavanaugh of Cavanaugh Ford in Salisbury and Lindy Jarvis of Jarvis Chevrolet in Denton.

STATEMENT OF SANDY MacGLASHAN, KINGSTOWN TRACTOR CO., CHESTERTOWN, MD.

Mr. **MacGlashan**. Thank you, Mr. Chairman, I might point out that the auto dealers do have similar problems as the farmer. But there is a considerable difference in the way they operate their business.

Senator **Sarbanes**. I understand. And we want you to outline that for us, if you would.

Mr. **MacGlashan**. I have been asked to represent the farm implement dealers here on the Delmarva Peninsula, more specifically Maryland and this district.

And we have heard quite a bit of testimony as to the effect of interest on the overall economy here. And it is many-faceted, as we all agree. There's no question, so far as the farmers and the dealers go, that we are completely integrated. Our whole fortunes, future, and life is involved with agriculture. Many of us own farms, as well as being in the farm implement business.

The price of grain is probably the most immediate factor and indicator, and creating a problem with implement dealers, which is flat or no sales.

One of the problems we have, in our industry, we order these large machines at least a year prior, usually, to the time of their sale and/or delivery. And so our inventories run very high. It's not unusual for any implement dealer to have at least a half a million dollars in inventory—and I'm referring only to capital or major machines. I'm not referring to 250,000 and upward of parts, accessories, shop equipment, anything to do with this plant. I'm talking about hard core iron sitting on his place of business.

When business is normal, of course, you have to ebb and flow, very similar to the automobile dealers, of equipment coming in and inventory turning over. You can use the word "turnover".

What has happened is our turnover has stopped.

Now, it's important that the real difference in our business is that we are seasonal. A combine is used roughly 90 days a year. The key factor is the time of year—in the fall if you use them for wheat, but wheat is not a big factor on the Delmarva Peninsula.

So, in essence, our suppliers give—and I think I can speak fairly accurately concerning all main lines. We have Massey-Ferguson, but I think I can speak for John Deere or International, in that the system is fairly much the same. We have terms—in other words, machines are delivered to us with floor plan terms, no interest for a period, and then with a period—an extended period with interest, and then a due date.

And I would like to put to rest in anybody's mind now—I think many people think that the dealer at any time, if he doesn't sell his equipment, he just sends it back. This is not the case. We are invoiced for it. We have bought it. The only way that we are going to get rid of it is either sell it or terminate, the dealer. At that time, you pay quite a premium for turning the machinery back.

To go one step further, right now the interest rate for maturity—and I'm speaking—not past due, but your floor plan has been extended with interest. At the present time it is 23 percent. If you go past due, it is 24 percent.

And quite frankly, nobody can live with that, particularly when you recognize that in our type of business that our general markup runs from 23 to 25 percent. And if you add trade-ins, the burden of trade-in dollars on large combines, large tractors, the interest begins to be our whole life's blood, and it is the thing that we think about. Money doesn't bother us; it is what it costs. Money is a tool.

And please doesn't misunderstand me, Senator, but I feel very strongly about this, and I think these gentlemen next to me will agree with the same thing. Money is a tool, and it is the cost of money that is killing the American businessman right now. And it's going to wipe him out if we don't get something done about it.

A large combine—I would like to throw out, to give you an idea what immediately hits the dealer—a complete large combine will cost the dealer $75,000 to $80,000. I said "cost the dealer." I'm not talking about retail. A retail of a large combine today runs $115,000.

Incidentally, this is what these farmers face—as that's an interesting facet you ask them about, capital investment. These are the type of capital investments these men normally can and do make to run their business. Farming is a big business; it's big money. And support services, such as the implement dealers, are in the same fix.

So, it doesn't take too much imagination to see that if a dealer had to pay for one or two combines, had $70,000 to $80,000, based upon 23 percent—or, in this case, if he is past due, of 24 percent—then he's not going to last but a very few days.

With that, I think I would conclude my statement.

I can't document at the moment—I could, but I've just been told by a friend of mine, with me, that 35 dealers since January 1 have terminated in the State of Pennsylvania. Massey-Ferguson lost one dealer recently right in this immediate area due entirely to the interest problems. It wasn't that he ran away with the company's money or anything else; it purely was the load became too great.

I think I can safey predict, again, that October 31 is the end year for all major machine manufacturers and it is also, hopefully, payday. Most of the farmers know about—and at that time of year, when they've had a good year, they either contract, agree, and/or buy the machinery; the company finishes each year, and you know where you are, hopefully.

I can safely predict—and I've spoken with some dealers. I don't wish to reveal some of their figures, but I can tell you one dealer faces, by January 1, $600,000 in machinery he must pay for if he wishes to continue to be dealing—so that his answer is fairly simple—and I'm referring to a good dealer, with a tremendous investment.

With that, I conclude my statement.

Senator SARBANES. Before we hear from the others—and then we will have a discussion—let me ask you this question. When, in the recent past, did you think you had a more reasonable situation, to deal with, and what was the situation? What kind of interest rates were you then facing? And how did that alter the situation?

Mr. MACGLASHAN. The interest has been applying pressure, as you know, steadily. I think it probably reached the crisis proportions when it went past—over 13 percent.

It is difficult to tell, because—how your inventory might hit—or, in other words, when you hit a big lump, that you've settled. In short, you owe the company for items which you must pay for.

Also, you have to have other lines of credit. I mean, it's no secret right now I've got $135,000 with my bank—on floor plan for machinery that hasn't sold—which is drawing interest right this moment.

I didn't mean to evade the question. When it passed 12 or 13 percent, it started to apply pressure in relationship to the cost of doing business.

Senator SARBANES. This is interesting. We're used to having 6, 7, or 8 percent interest. And when it went up, everyone just said, "If we could just get back down." The range has shifted, but I think it is very clear that the high figures that we're at now cut off virtually all economic activity. Are the farmers even coming to you for the equipment? What kind of decisions are they making? To postpone purchases?

Mr. MACGLASHAN. Frankly, Senator, I wouldn't have the nerve—I mean, as I said, we are all very closely knit; we're all neighbors, and we're all involved in the same business. And to try to convince a farmer—and let's also recognize that the farms here in this area are very fruitful. They have been very successful in the past. There is a tremendous amount of investment in the richness of this country, and that's why I think many of us are really concerned. It is our whole being.

Senator SARBANES. I think you're right to make the point, and it's often overlooked. We take far too much for granted in this country, namely, the enormous contribution which agriculture makes to the economy.

Agriculture is enormously productive. As a consequence, with a very small percentage of our total population, we are able not only to feed ourselves but a good part of the world as well. No other country in the world can even begin to approach that. Even the countries that can feed themselves almost invariably have a large percentage of their population into it.

The further consequence, though, of being so good is that with a relatively small percentage of your population involved, the rest of the population tends to overlook the contribution made by the farm sector to our own well-being here, as well as to our economic strength abroad. I urge you, on any occasion that you have, to underscore that contribution.

Mr. MacGlashan. Senator, I will take this occasion at this point to say that this is probably the beginning, that the grain embargo is really the beginning of part of this problem. And I realize you're not responsible for it. But as such, I would like to say to you that why doesn't the Senate or the Congress of the United States get started using food as a weapon? We have many people all over the world that apply pressures to the United States. I don't mean to withhold it from starving children, but why not sell it for a good, fair price in the world. Anything they sell us, we have to pay for. Rather than shipping them guns and bombs, ship them food.

And that is an impassioned plea, I recognize. But if you look at the dollar volume that we're shipping overseas—and I remind everybody, 1974 is what saved our proverbial fanny in the balance of payments, was the agricultural shipments that, along with the aviation aircraft, were the 2 million items.

I couldn't be happier to say to you and the Senate of the United States that if we could start using food in a humane way, but in a sensible way—sell it and get paid for it.

Senator Sarbanes. Let me ask one further question.

You say you, in good conscience—given your working relationships with these farmers—that you can't really urge them on?

Mr. MacGlashan. I am sorry, Senator, I got carried away on that.

I couldn't, in all sense, advise any farmer to buy a new combine with the rate of interest, with the grain prices at a break-even point. After all, these guys would say to me, "Have you lost your mind?" And this is the position we find ourselves in.

Sure, we're willing to get out and sell. We provide a service. And we have to sell to survive. But it is just not there, not in the current economic situation.

Senator Sarbanes. Are you moving more in the direction of not carrying an inventory, almost becoming an agent for the manufacturer to receive the farmers' purchase commitment and pass it on without stocking an inventory? Are you being pushed in that direction?

Mr. MacGlashan. The companies well recognize that that would stagnate the situation. I believe I'm correct that there is roughly 15,000 or 18,000 combines built in the United States in a given year. I know Massey-Ferguson itself, I believe, last year made about 7,500. They're one of the larger manufacturers. Quite frankly, it is a matter of timing. You couldn't wait for the sales force to make these commitments, and then say, "Okay, we need a given amount of combines." There just isn't enough time for them to get their suppliers going. In other words, they must buy.

And incidentally, I will answer you this way: the factories buy bearings 3 years ahead of time. They're got to project production that far ahead.

Senator Sarbanes. I think that is a good answer. Let's go on and we will come back.

Mr. Cavanaugh.

STATEMENT OF PATRICK H. CAVANAUGH, JR., CAVANAUGH FORD, INC., SALISBURY, MD.

Mr. CAVANAUGH. Senator, you are familiar with my dealership and our town. We are coming up to a 50th anniversary this year. We started in 1932. And it would be difficult to predict a tougher time for automobile dealers than this past year or perhaps the one coming. There were approximately 45,000 dealers in the United States after World War II. We are now heading for about 20,000, and there are predictions that approximately 15 to 20 percent of those dealers will go out of business in the next year.

There are only the quick and the dead surviving in this business, and either you operate at maximum efficiency or you are out of it.

You have asked some of the farmers what their plans for one of their sons are. My son likes my business. I'm encouraging him to take a general business course. He is also pursuing acting, since there seems to be some market for actors in the Government. [Laughter.]

A few specific examples. I'm carrying approximately half the inventory I used to carry. I operate now more or less on the Sears, Roebuck theory. You come in and pick out the car that you want and we will order it for you. Unfortunately, the manufacturer tells me he can't operate on the same basis and, consequently, he is closing down lines, putting people out of work, putting suppliers out of business.

And the thing has a very vicious cycle. It used to cost in August of 1978 about $58 to stock a $7,000 car for 30 days. Now it costs $125 to stock that same car. We try to only orders cars that move every 60 days. Now that is extremely difficult. It leads to stocking everything in vanilla. You get a nice bland car that you can more or less sell to everyone. So selection, as far as the American public is concerned, is going down dramatically.

Currently, the industry has an 81-day supply of cars. Our thinking is that you can support 45 days now. That is what you should go for. That 81-day supply costs dealers $22 million a day; $22 million a day. That represents from 21 percent to 23 percent, depending on who you're doing business with. And incidentally, we're doing business only with our captive finance companies. Banks are out of this business.

I think to stay, they have very efficient computers now. They know where their money makes the best return overnight. It definitely does not lie with automobile dealers, with the customer who finances a car, and with the short business loans, a long-term is 48 months, and a good business loan is 90 or 120 days at 2 points above prime or 3 points above prime. It is quick; it is easy; it is painless; and the guarantees are much better than the individual consumer or the automobile dealer. I don't blame them. I envy them.

At one point we were told by a bank that we had the best operation in the State of Maryland. It did not happen to be a Maryland bank, incidentally. The next statement was, "We are terminating our arrangement next week." And I understand that we now do business exclusively with Ford Motor Credit. And there is a problem there. Their money sources are not limitless. They have been able to borrow money in the 14½- to 15-percent range.

Recently, on about the 5th page of the Wall Street Journal, just a small article. "Ford opens up its credit lines with banks, willing to pay in the 20-percent range for money." The banks were shocked. "You have never used that credit line. Why are you starting now?"—"Because we need it. And we want to know its there. And we want to test the water to make sure you got it."

If they're willing to pay that, what must they charge the consumer?

Incidentally, on that consumer charge, we figured on a $7,000 balance that the amount he pays for interest now on a 48-month loan with a normal $1,000 down payment is up between $25 and $30 per month. So he is buying less car for his money and paying more in interest.

A couple of dictums have come back in this business. The Henry Ford maxim "You can have any color, as long as it's black," is now seeing new vogue, because you don't stock the exotic colors, you stock the basic ones.

Besides selling cars, we also used to fix cars on credit for people who couldn't pay the entire bill. This was quite normal, 90 days or 120 days. Now comes another sign in the service departments, "We will crank your Ford or hold your baby, but sell for cash and don't mean maybe."

There is no credit being extended to people who need it. And what happens in all of this on the consumer side is those that need transportation perhaps the most and have the most difficulty in paying are very efficiently cut out of the system. If you're Ford Credit and you only have a limited number of dollars, you're darn sure going to take the bottom 20 percent off the credit pyramid and get rid of it. You don't loan to them. Very strict credit procedures. If you're ever over 30 days on any obligation one time, too bad. Those banks still loaning money want 30 percent down, flawless credit, preferably a couple of CD's in their bank. And if you're on the board of directors, that also helps, but not necessarily.

So all of these things simply indicate that without credit, business in America is pretty much dead.

I hope that some of these gentlemen here would offer to you some suggestions on what could be done. Most of us are getting complaints, but not much in the way of suggestions. Many of my contemporaries think that we have got to stick with budget cuts. They are less sold on tax cuts. They are more sold on tax advantages.

I know we are going to have some people here from the real estate business. How about some kind of credit document that can be purchased at considerable tax incentives with the money specifically earmarked for buying new houses? I would love to see that. I would get some contractor to pick up business. Any time you take a strain off one sector of the economy, you help another.

Personally, the tax cut, I feel most people will spend that simply to maintain their standard of living. It will not go into savings, unfortunately, as hoped.

And the automobile industry and the home industry are really two of the real products that go into the gross national product. If you remove them and use the available moneys to service the debts, the built-in features of escalator clauses in the cost of living, it becomes a vicious circle. And no real goods are going to be manufactured.

That is something that concerns us. We also believe that perhaps Mr. Volcker is a little more tenacious than he need be. And, whereas, I understand that he cannot be removed or perhaps influenced in any way. I think the Congress proved with the Federal Trade Commission, that there are ways of getting the attention of bureaucrats that do not do what the Congress would like them do. And perhaps some of that could be pursued.

And yet for the most part I think our industry supports Mr. Volcker's position.

Senator SARBANES. It seems to me that a couple of things need to be established. I would like to comment on that. I think the premise has to be changed. I saw Paul Volcker Sunday on television, and his premise is essentially that we have a difficult period to go through and everyone must weather it. Now you know, there is no guarantee that at the end of the difficult period you really will come out of the storm. You may be even deeper into the storm, which is, of course, what has happened in England, where things continue to move downward and get tighter, and the situation continues to worsen.

But leaving that aside, it seems to me that the premise is faulty. I don't think we can tolerate a situation, as I think we have done with the interest rates, where we have established, ongoing, effective businesses who say that they just won't be able to continue this way. We're not talking about shaking out marginal people. We're really now talking about transforming the economic structure. In one way or another, the very large concerns are able to keep going, or they seem to be able to keep going, and you're just squeezing out of existence but a lot of smaller people who have functioned very well are being squeezed out.

I see the high interest rates as contributing to the problem which, in many respects, they were supposed to solve. The interest rates themselves become a contributing factor to the inflation which they are ostensibly designed to curtail. So the costs are passed on—the cost of money goes on to the consumer. The housing industry passes it on in one way or the other. In the past month, the biggest factor in the sharp jump in the Consumer Price Index was housing cost, both interest charges and also the cost of homes which apparently are being pushed upward because an assumable mortgage is simply factored into the price. The cost of the home goes up and is reflected in the Consumer Price Index.

The other side of this deals with the Federal deficit. I was interested to hear your comments on the tax cut, because obviously you could have had one of less magnitude directed to encouraging savings and investments and providing incentives for greater productivity, which would have been less a total package.

The high interest rates contribute, as I see it, to an increased deficit very directly in three aspects. One, the carrying charge on the Federal debt goes up. Two, the cost of goods and services to the Government increases, because the cost of money is being factored in. And three, high interest rates provoke a downturn and a recession, because in certain sections of the economy people who were working and being productive are jobless.

We had testimony this morning from the Home Builders. One witness said that he's had to lay off all of his people. He says they're either not working now and drawing unemployment, or they're working 1 or 2 days a week. So they're not paying taxes in, and the ones drawing unemployment are pulling money out of the Treasury. It seems to me if we continue on this path, it has in it the seeds of all of those things which, compounded, could well worsen the situation.

We will come back to that. Mr. Jarvis, why don't we hear from you now?

TESTIMONY OF LINDY JARVIS, JARVIS CHEVROLET, INC., DENTON, MD.

Mr. Jarvis. Senator, it appears to me that our industry has been in a downward spiral for sometime. As interest costs increase, dealer inventories must reduce. Reduced inventories slow sales. Slow sales reduce inventories. On and on. It seems that in my own case we have bottomed out of that particular spiral, but at an unacceptable profit level, and in many cases, no profit level.

Our inventory has reduced 48 percent from July 1, 1980, to July 1, 1981. Slower turnover means higher cost per unit as interest gets figured daily. Less volume means higher fixed cost per unit that must be passed on to the consumer. Any business requiring an inventory has a continuous problem. The extra dollars required to cover cost of inflation must come from after-tax dollars or borrowed at high interest rates. Again increasing costs per unit. High interest rates require customers to finance for longer periods of time which keeps them out of the market longer.

High rates in some cases defer buying by people that have money. With a variety of investment programs available, people hesitate to give up great returns to buy a new car. Reduced sales, in my opinion, do not indicate the lack of desire to buy. High interest rates, coupled with rising cost of living make buying a car impossible for a large number of customers.

It is my understanding that for the past several months the scrap rate is greater than production. Since each day we have more drivers in the United States and less cars, the customers' needs for transportation are increasing. Since high costs of money affects the companies and municipalities, as well as individuals, they too are delaying purchases.

For example, if I understand it correctly, Maryland State Police now are driving cars 3 years instead of the previous 2. High interest rates have reduced company profits in many cases to a point where interest deductions are of little or no value. As long as Government takes large amounts of money out of the market at high rates, I see no relief for the consumers.

I guess I would view the light at the end of the tunnel a little brighter if I understand how supply-side economics can work, when money is not available at affordable rates for growth.

Our industry for some time has been troubled with high labor costs, Government intervention and an unfavorable press. Of the many news items I've read and seen, I rarely, if ever, have heard that the consumer loan rates on new cars are below prime. In the first half of this year, it was pretty popular on the news each night to talk about the different metro banks that have gone out of the consumer loan business for greener pastures. I don't blame them, but it was rare to hear anybody say that the GMAC never ran out of money in the past 53 years.

Thank you.

Senator SARBANES. Thank you, sir.

Let me ask you this question. In the financing of your cars before the current situation, in percentage terms, where were your buyers finding their financing? How much of it was through you back to the company, and how much of it elsewhere? Do you have some sense of that?

Mr. JARVIS. I would say that—do you mean like 5 years ago?

Senator SARBANES. Yes.

Mr. JARVIS. I would say 5 years ago the average rural dealer, which I would be more familiar with, would finance probably 40 to 45 or 50 percent of the sales. Now a lot more were actually financed, but we didn't necessarily know it. You know, the guy borrows the money directly and comes and buys the car from us. But roughtly 40 or 45 percent of those we handled ourselves.

Senator SARBANES. And where was your financing coming from?

Mr. CAVANAUGH. The source was 30 percent from the captive sources in those days, and that has now jumped into the mid-1960's.

Senator SARBANES. You were then 30 percent from the captive companies and 15 percent from your own sources? Is that the 45 Mr. Jarvis is talking about?

Mr. CAVANAUGH. I think he was talking there about what percent financed. The question you asked was, where does the money come from?

Senator SARBANES. Well, let's start from the beginning. What percent of your consumers, to the extent you know, finance their car; 85 or 90 percent in one way or another?

Mr. JARVIS. Roughly, yes; 80 to 90 percent.

Mr. CAVANAUGH. Absolutely.

Senator SARBANES. Five years ago as well?

Mr. JARVIS. Five years ago, no.

Mr. CAVANAUGH. No, that would probably be down in the high 1960's—65 percent.

Senator SARBANES. Now to the extent they were financing, where was was the source of the financing coming from?

Mr. CAVANAUGH. Well, now it is easy. There is only a couple of ballgames in town, and those are the captives. I would say they are up handling in the 80 percentile group and with credit unions and banks coming in there, to the extent they have got some really prime customers that they want to handle. Before the captive finance companies were down in the 30- to 35-percent range, so they have had a tremendous step up. If it wasn't for them, we would be literally out of business, and you can see now the effect of the General Motors 13.8 rate. They are selling exactly twice as many cars this month as Ford and Chrysler cars. So if you don't think that credit terms make a difference, ask my friend, the General Motors dealer, because he's got all the customers.

Senator SARBANES. He's the only one at the table who can even approach a smile.

Mr. MacGlashan, let me ask you where the soruce of credit came from. Your manufacturers don't provide that, do they?

Mr. **MacGlashan**. Oh, yes. In the past, I would say the majority of the loans were with the banks, particularly in our area. It does vary, depending upon whether you're talking about grain, in areas of predominantly grain and predominantly dairy. But I would say 5 years ago, at least 60 percent was handled by outside sources of one sort or another. Any sales that we are making at present—let me back up and put it this way.

Right now, one of the sale features is similar to General Motors, of 13.9 for 2 years, and then at the end if the contract is going longer that, we rewrite it. It is a ballon situation—a complicated contract. We guarantee it won't be any higher than the going rate at that time. This is a sales approach. It is a rather complicated one, in my estimation, but most of the large farmers today—and when I'm referring to large, I'd better be careful on the percentages. If you're talking about farmers who own their own land, they've established lines of credit with their own banks, and I would say probably 90 percent of their capital purchases are handled by their bank. And you have a great many farmers, particularly the younger segment of farmers coming up, who have had help, getting ongoing by their father or various people, where situations, hopefully in the past, where they could, and they would use the captive system as much as possible.

But fortunately in the past—as a matter of fact, many of the implement dealers in this area encourage them to establish lines of credit with their banks for very obvious reasons. In other words, our accounts receivable, just in parts of labor, run to very high figures. In the past, we used to have to wait almost until crop time to get these dollars. But in the improvement, the better business practices of agriculture, the overall picture, establishing lines of credit, we still have problems; we don't have as much.

I hope I haven't rambled, but it is—right now, it is a tossup. The man with good credit, if he's going to buy, he uses a bank. But he will use waivers.

To get back to sales programs, where you have waivers of interest, for instance, until next May—in other words, you can buy a machine and pay no interest charges on the balance until next May, and then you have an option of paying it off then or continuing with the contract—they will take advantage of that, but the fellow with the line of credit next May will pick it up.

Senator **Sarbanes**. Are the manufacturers pushing more of the cost involved in all these situations onto the dealers in one way or another? Or are they trying to get in the boat with you?

Mr. **Cavanaugh**. They are in the boat, bailing furiously, to the extent that four dealers were in the black last year. That figure almost exactly coincides with the interest supplements from Ford Motor Co. Without them, there would have been no dealer profits last year.

Senator **Sarbanes**. Mr. Jarvis?

Mr. **Jarvis**. I think GM would be pretty much along those lines. Another thing on the interest rates that we were talking about, it is kind of interesting how sometimes, the stuff is a little hard to track, too, like now we have this 13.8, which incidentally has just been extended another month, which is fine. But you see it is really a price reduction of a fashion for the short-run period of time.

Other times, we've had the rebate programs of different fashions and what have you. So this time, it was GMAC's turn to pick up the tab, I guess, and it does make a considerable difference, because on a 48-month loan with an unpaid balance of $6,000, it is over $600.

Senator SARBANES. I noticed earlier you talked about the 48-month loan. The loan period is lengthening isn't it? The same thing, I assume, is true in the farm equipment business. What is the normal term?

Mr. MACGLASHAN. I have some going 4, some 5, and some even 6 years.

Senator SARBANES. What did it used to be?

Mr. MACGLASHAN. An average of 3 or 3½, not over 4—very rarely over 4 years.

Senator SARBANES. And for the auto dealers, didn't you used to be 24 months?

Mr. CAVANAUGH. That's right.

Senator SARBANES. I saw an article the other day which likened the automobile situation to mortgages. What is the impact of this lengthened time period? When the person gets to the end of it, he's right back on the treadmill again, isn't he—or not?

Mr. JARVIS. In some cases, if he didn't care for the property, he might not make 48 months. Of course, 48-month financing has to be done vary carefully and selectively. Everybody is not a candidate for 48-month financing.

Mr. CAVANAUGH. Preliminarily, it has not been the problem that the industry though it was, however. The trading cycle lengthened out only a couple of months more than normal. I think it is like 28 or 29 months now, and it was like 24 months when people were trading. It may be too early to tell. Right now it is not conclusive as to what will happen.

Mr. JARVIS. I think more trade-ins will increase now after July 1 because the actuarial replaced the rule of 1978's on prepayments, and for a guy who would finance a car now and buy a new one when he still has a balance, it would be far more encouraging, I would think, after a contract written July 1.

Senator SARBANES. Mr. MacGlashan, what is happening to the farm structure under this pressure, in terms of the family farmer? Do you see a pattern at work there, and is it being pushed along by these interest rates, in terms of who takes over ownership of these farms and production?

Mr. MACGLASHAN. I think, Senator, if you talk about the current problem with interest rates, as Mr. Spies testified, a young man starting up alone today is just impossible. He has to have help, either from family or somebody has got to give him a start. But I think this: We are in a terrific vise right at the moment. The recent new—the tax laws going through as far as inheritance—in other words, I'm trying to use the proper word—your estate has allowance deductions, and hopefully that will be the salvation of the family farm.

I don't think there's any question, that I ever talked to anybody in agriculture who wasn't really encouraged by that facet, because now unless inflation keeps galloping and then it runs away from those figures—but at the moment, that is probably the most encouraging thing that has happened. At the moment, any young man who is involved in farming, depending on how much credit—line of credit they have and their actual position and who is backing them—a young man is in jeopardy today; there's no question about it. He can't stand another year or so of this tremendous pressure from interest because obviously he is not selling—any interest—the established farmer is suffering; there's no question about it. And it all depends basically upon his position. If he has a lot of equity, he can stand a lot of bruising.

But, in other words, the amounts that we are talking about can surely accelerate.

Senator **SARBANES**. Do you find established farmers saying, "Well, it's just not worth it anymore. Why don't I just liquidate my capital and put it in these funds or CD's and just sit back and enjoy myself?"

Mr. **MACGLASHAN**. Senator, I will answer that this way. There's no bigger fool in the world than us farmers. Every year when we smell that dirt in the spring, we're raring to go, and that's what makes us farmers. That's the only answer I can give you. If you have a love of the land, you'll never lose it, and we will starve before you can push us off. But it is getting difficult.

In the old days—we were talking about it this morning—the pressure wasn't felt, for instance, in this area. It was bad; don't misunderstand me. But farmers lived off the farm other than sugar and salt and a few things. Down here with all the grain and the way farming was done where you cattle stock and grain and everything on the farm, nobody went hungry on the Eastern Shore.

But today, with the economic structure we have and the commitments we've made to modernization and the large equipment and the grain operations, it is just everyone, every citizen in this country, whether he owns a farm, a business, whatever it might be, has got to have so much income or we are in real trouble.

Any commitments we have made have been forcing the floating situation on interest. You feel like a sitting duck out there, waiting to see what's going to happen next. You can't plan. We can't project any plans for our businesses, and I'm talking about the farming business. Really, at this point, I'm kind of in between. I own a farm, and I'm in the farm implement business. My first love is to farm; there's no question about it. But it is all tied together.

And even Mr. Cavanaugh and Mr. Jarvis' situations are the same, and they are tied—every bit of their business is essentially tied to agriculture because that is what is down here on the shore.

Senator **SARBANES**. Let me ask it this way. Do you have any sense that with the money market certificates money is being drawn out of virtually all communities in the country, with the exception of the money centers, that the money is being pulled into the money market center and, in a sense, kept there? If you look at the investments, you know it is the Eurodollar market; it is the paper of the Fortune 500. That is where that money goes.

Do you feel here that the money is being pulled out of the area and thererefore is less available to you?

Mr. CAVANAUGH. Certainly. Those institutions do a superb marketing job on getting that money. And now, I guess, they are trying—paying you that interest in advance. It is sort of a bonus, I guess, which is questionable as to whether or not the IRS is going to allow it. But certainly to the extent that I had some money, that is where it would be going, right out of the savings and loan, and I'm using that to offset other decreases in income.

Senator SARBANES. Well, thank you all very much. You've been a very helpful panel, and we appreciate it. We are glad you did some preaching, Mr. MacGlashan; it's been very helpful. [Laughter.]

I think we will have the small business panel now, if we could: Mickey Collins, Larry Simms, and Thomas Weber. If they would come on down, we would appreciate it.

We had some very effective testimony from Hursey Porter this morning, and I see he's managed to catch up with us. He testified after the Governor gave a really effective statement.

Well, gentlemen, we are pleased to have you with us, and it's good to see you again.

Larry, why don't you lead off?

This is Larry Simms, head of the Maryland Watermen's Association.

STATEMENT OF LARRY SIMMS, MARYLAND WATERMEN'S ASSOCIATION, ANNAPOLIS, MD.

Mr. SIMMS. I'm pleased to be here, and I'm glad to see the thoughtfulness and the concern that the Senate has, because it is a big problem.

The watermen's problem on the Chesapeake Bay, as far as it goes—the whole east coast or the whole country—the fishermen and the commercial watermen of the United States all have the same problem that the farmers have, the same percentages, and all that can be related right to the fishermen that you have heard on the farmers.

Our problems are the same as the farmers in that it costs us more to operate, probably three times as much to operate today as it did 10 years ago, and we are getting less for our product. There are two reasons for getting less for the product.

One is the increased cost of fuel, which is passed down to us, and we, being on the bottom of the pile, we don't have anywhere to pass it. And then the other is the interest cost.

Now, aside from it costing us more money to purchase equipment to operate with, the big problem that we're having is the cost of the packers and the processors and their interest rates. They are no longer buying when we have an abundance of seafood in some areas and our product is very seasonal, and so we have an abundance of seafood, like we have crabs this summer. Our problem is that the processor cannot afford to freeze and store that for any length of time because of the interest cost. So therefore even though we have an abundance of crabs now, we will have a shortage when the season runs out because none of the processors have been able to store it and hold it because of that increase in interest. They operate on the interest, and they can't pass but so much on to the consumer, and that gets passed on to us.

To give you an example, right now we sell crabs for $5 a bushel, and we're only working 3 days a week because we don't have a market for them the other day. Two years ago for the same crabs we were getting $15 a bushel, and that's for the No. 2 crabs, the small male crabs. So with the increase in the cost of operating, you can see where our problem is.

We noticed that last year with the oysters. During the winter months is the time that the processors freeze them. Even the military used to buy oysters and freeze them. We have sold or the processors sold to the military their frozen oysters. Last year we didn't have an abundance of oysters, but when the winter months came, we didn't have the market either, and that was due to the interest rates. They couldn't afford to take the gamble and freeze them and think they could get their price to make up their interest. So that's a big problem there.

Our problem is the same again as the farmers. The young people coming into the business aren't able to buy a new boat or new equipment. Consequently we have the older fishermen hanging on, and they're going to hang on because that is their life; that's all they know how to do; and they will stay there even if they starve.

But what happens to those people? Even though we have to keep upgrading their equipment, what we are doing right now is nursing that equipment on because we can't afford to say, "Buy a new diesel motor for $13,000 or $14,000 at 18 or 19 percent interest." So we are nursing our equipment on. But that is going to have a disastrous effect in the future because once that piece of equipment has been let run down to the point of no return, then your investment—you have no trade-in value; you have nothing; you have to start from scratch, and you might not be able to do that.

Senator SARBANES. And of course you are inefficient.

Mr. SIMMS. You are very inefficient at the time, especially with our harvesting gear like clam rigs and oyster rigs, crabpots, fishing gear. You can coast for 2 or 3 years without borrowing, but the problem is, your equipment is getting less and less and is deteriorating, so it is less efficient, and you are making less and less money producing less and less seafood. And the end results are going to be very disastrous.

Now to answer some of the questions you asked of the other gentlemen, we do have some of the new watermen that have folded up. They couldn't make their payments, so they had to let their boats go and go back to work for some of the more established people.

But it's going to have a chain reaction as you go on to the established people. We can't keep operating without replacing our equipment. And we can coast awhile like we have been doing for the last year or so. When the interest rates got to 10 percent, when they started over that, then we started to get into trouble. Short term, we could probably live with 12 or 13, but long term for the big capital investment, 8 or 9 percent, when you get above that, you are hurting.

The Chesapeake Bay is a little different than the ocean side, because in the Cheasapeake Bay you are owner/operators. You own your own boat, and you operate it, and you've got one, two, or three men in your crew. And your capital investment to begin with is less. But overall, your total amount of income for that year is also less, too. So the percentages work out the same.

The fellow on the ocean side who would lay out $400,000 for a vessel and then another $200,000 for equipment, they are hurting the most, and there's a lot of them going under. The ones with new vessels are really in bad trouble, and it is due to the fuel costs and the interest. There's just no way that they can make it at these rates.

This country has—I heard the farmers express sort of the same concern. We thought the big salvation to the ocean fisherman was the 200-mile limit. We find that what we're constantly faced with in the 200-mile limit is more governmental controls, more restrictions, and there is still that foreign fleet which is coming in and taking what we can't afford to catch, because they make it too hard for us to catch them. And that's the fuel and the interest rates. So the foreigners are still coming in and harvesting our product, and we're letting them take it back. Some of it is shipped back to this country, and the American fisherman is really in trouble and really feels as though the Government is looking out and using it as a political tool for foreign countries and not really looking out for our interests at home.

And I think our fishermen generally feel that that is a tool we could use for some of these countries, that we're paying these enormous fuel prices to other countries, and we've got food here that those other countries need, and we should be getting the return on that. We should use that as a check and balance for these other countries. It's probably one of the best tools we have—the food this country produces.

The other thing that we see happening—and this may be getting off the subject a little bit—but being faced with the same problem, we have more people building on the land, so you have less and less land to produce food. You have more and more industries using the waters, the bays and the tributaries, for their sewage systems, and the municipalities using the water for their sewage systems, so we have less and less productive areas in the bay.

We're going to be faced with the same problem that all of the foreign countries are. We're going to have more people than we can feed, and this country really needs to take a good hard look at that, and we have to take care of it.

Senator **Sarbanes**. That's a good point. We have to take care of our resources. I was told in California they had taken 20 percent of the class A farmland out of production in a 5-year period. And it was done because it was the best bottomland—it was the easiest place for the developer to go. They could have shifted him not very far away into foothills, not as good a farmland. That would have been a little more costly for him to develop. But he was able to get away with taking the very best land out of circulation. Of course that problem comes home to roost; all of a sudden, it's right in front of you, and all of these resources, both water and land, that you are depending upon, have been depleted and shifted into some other use, and then you're not able to get them back again.

Mr. **Simms**. That's entirely true. We have the same problems. Even though we don't build on the water, it is narrowed down. We have so many people that want to use the bay, for instance. You have your shippers, your big shipping companies. You have your big industries that need the water for cooling or their process or disposing of what they have. Then you have the recreational users. And they all want to use the bay for their purposes. And they have no thought about what it is doing. What we're really going to need the bay for in, say, 20 years from now, is supplying food. And the Government kind of falls in line with that, because they constantly restrict us on the areas that we can work, because of, maybe, pleasure boaters don't want our pots in the way, so they say, "Well, we're going to cut this area out. You can't set pots there."

Well, they are narrowing all this down and giving it away to different factions. And eventually you will move all of the watermen out of the bay, and what few will be left will have to be the older fishermen, and you will lose that estuary as a producer, just the same as you are using the good farmland, and your estuaries will produce more than, say, the ocean for more people.

Senator **Sarbanes**. Particularly this estuary, which is probably the best in the world.

Why don't we hear from Mr. Weber, and then we will come back on the joint problems of small business.

Mr. Weber, please proceed.

TESTIMONY OF THOMAS A. WEBER, VICE PRESIDENT, NUTTLE LUMBER CO., DENTON, MD.

Mr. **Weber**. Senator, the high cost of interest has had a very adverse impact on our firm and on the housing industry in general. As a matter, this is the biggest problem that if facing us today, because of the interest rates and other inflationary factors. We had to take a hard look at our operations and reduce costs wherever possible. We have had to reduce our inventories to alltime low levels.

Many of us have had to postpone necessary plant and equipment improvements and, unfortunately, some of us have had to lay off valuable employees. In order to stay in business, we in the housing industry have had to reduce our profit levels to alltime low levels, and in spite of these actions, we have continually passed on to the consumer price increases that he has to accept. These increases on top of the high interest rate the consumer must pay in the form of mortgage, has caused us to price ourselves out of the housing market for many people, particularly those people who are young, first-time home seekers and those people who can only afford low- and medium-cost housing.

As a matter of fact, the only people who are building houses today are the people who don't need them. Here on the Eastern Shore, virtually the only construction that you can see being built are high-price custom homes, vacation houses, and beach cottages for the affluent.

Two weeks ago I talked to the president of a local sectional manufacturing firm located not too far from here. He told me that up until last year approximately 30 percent of his production went to the young, first-time homeowner. He also told me that this year he sold practically no houses at all to this group of people. His firm is now manufacturing five houses a week, one-third of its capability.

As a matter of fact, just 10 days ago, he had to lay off an additional 40 workers. The high interest rates are also affecting the sale of existing houses by people who want to sell them for various and sundry reasons. They can't sell because of the high mortgage rates, and they require the equity from these homes in order to build anew.

Needless to say, we've priced ourselves out of the market for these people as well. The problem appears to be growing worse and not better.

Predictions available to us now indicate that 1982 will be no better for the housing industry than was this year.

Thank you.

Senator **Sarbanes**. Gentlemen, I want to thank both of you. Those are very thoughtful statements.

Mr. Weber, let me ask you this question. This builder you were talking about has gone from 15 houses to 5 houses a week, and he has laid off 40 additional workers. In your view, what does that do to his efficiency? I'm increasingly concerned, particularly as I listen to homebuilders, about the effect on their efficiency of the boom-and-bust cycle. It seems to me they put together a good work force, train them, and get them working together, and they're pretty effective; and then they have to bust the team apart and let them go. Consequently, they are not as efficient in whatever production they are able to continue to do. And then, when production goes back up, often they can't get back some of the really good people, who have managed to go somewhere else in the meantime and get themselves into more permanent situations.

Do you see that happening?

Mr. **Weber**. That probably is his biggest problem. That when and if the economy turns, first of all, he is going to be reluctant to turn another line on, because you don't just throw a switch. You've got to go out and buy additional material. You've got to acquire new personnel and train them. And this costs him a tremendous amount of money, before the first house runs off the end of the line.

So he is not going to turn that line on, until he is convinced that it is here to stay, or it at least has a good chance.

So replacing the workers is one expense. Another, he is inefficient right now, because he cannot buy in the quantity today that he could when he was running 3 lines or 15 houses a week. When he buys in smaller quantities, his costs go up.

Senator **Sarbanes**. Now you say you yourself have been laying off valuable employees?

Mr. **Weber**. No, sir. We have been fortunate; however, many of the contractors in our area, many of the lumber yards in our area have had to lay off people. Fortunately, my firm has not yet had to face this.

Senator **Sarbanes**. And what happens to the people who get laid off?

Mr. **Weber**. The same place the others go. Unemployment——

Senator Sarbanes. That's what I don't understand about this policy. It just contributes to the deficit. When people work and earn they pay their share of taxes and do not draw out of the Treasury. You throw these high interest rates on them, and they get laid off. They no longer work and pay taxes, and then they start drawing unemployment.

That's why I said earlier that the policies in many instances are working against themselves.

Mr. Simms. It seems to be causing inflation more than cutting it down. In our product, even though we are getting a lot less for it, the man on the last end, selling it to the consumer, where the consumer himself has to pay more for it now than they did, say, 3 years ago or 10 years ago.

Senator Sarbanes. And a lot of that is carrying charges.

Mr. Simns. It's all the carrying charges. All the way up the line everybody has that interest, and the consumer is paying it. And in our business what is happening is our seafood product is more of a luxury item than it is a necessity, so people refuse to buy it. It is so high they refuse to buy it, even though we're getting a lower price than we've ever gotten before. The consumer still can't afford to buy.

Senator Sarbanes. Of course, as you know, from our past conversations, I think we must just work harder to improve marketing—seafood is a tremendous product. All of the health studies invariably find seafood to be a highly nutritional, highly beneficial food, and we've got to get people back in that frame of mind—particularly people in other States. Maryland is oriented that way, but a lot of States are not.

Mr. Simms. Well, a lot of that goes back to the interest rates again, because the processors, even though now they know the technology or maybe upgrading the product to put in the housewife's hands, so it will be better, more appealing for her to fix. They are not going to invest in that equipment to upgrade this process. So consequently, we're putting the product on the market in the same form we did 20 years ago. And it's not helping. Most of our seafood right now is sold through restaurants, because they perpare it. We don't have our seafood prepared, so it is appealing to the housewife. It costs money for the processor to do that, and he's not willing to do it at this stage, because of the cost.

Senator Sarbanes. Would you say that people in the waterman's line either wanting to expand or upgrade their operations or to enter it for the first time are almost totally dependent on debt capital?

Mr. Simms. Totally; yes.

Senator Sarbanes. There is very little equity financing, isn't that correct?

Mr. Simms. Yes. Even in our day-to-day operations we are very seasonal. We have three seasons or four seasons a year that we operate, so we have to have different equipment each season and consequently, people are staying in that season longer than they should, because they don't have the financing, and they don't want to borrow the money to change gear. And it is very costly, and we depend upon the banks and the financing to do it. The banks are more reluctant to lend you the money, and the interest rates are 18 or 19 percent.

Senator SARBANES. For your people, as between the cost of equipment—and I know there have been increases in the cost of equipment—and the carrying cost on the equipment or the interest rates, which is the greater deterrent in terms of going ahead?

Mr. SIMMS. I would say the interest rates, because the interest rates have gotten to the point now where you just barely can make the interest payment, and you can't pay on the premium. The cost of the product they see as the general increase in cost like everything, but the interest rate, it just keeps multiplying. And like I say, when it reached 10 percent, then we saw a big slowdown and how people kept their gear in shape and upgrading, Senator Sarbanes.

Senator SARBANES. Mr. Weber, by what percentage factors is home building off in this area?

Mr. WEBER. Excuse me?

Senator SARBANES. By what percentage factors had home building fallen in this area?

Mr. WEBER. Well, Senator, I think that depends upon the class of home.

Senator SARBANES. That's a good point.

Mr. WEBER. Custom homes, believe it or not, are better this year than they've ever been or at least that is our experience. The low and medium-cost housing in this area, according to the people that I've spoken to within the industry, is off between 60 and 66 percent.

Senator SARBANES. And how would you define low and medium cost. What ranges are we talking about?

Mr. WEBER. Well, that is hard to define, because the price changes every day. I think that today low and medium income housing is rated somewhere between $50,000 to $80,000 or $90,000.

Senator SARBANES. I think you are factually right when you say that. Now you said that vacation homes are proceeding apace, and there seems to be money out there for that?

Mr. WEBER. There is. The money is out there. And they are building here on the Shore. I think you can honestly say that this is the best year ever for custom housing.

Senator SARBANES. That's another point I'm quite concerned about—and that we're getting more and more to a two-track economy in this country, where we have a certain upper portion of the income scale that just moves along and isn't really affected very severely, and then we have the rest, and not the bottom part of the income scale, but the great substantial number of our people.

One of the strengths of our economy over the years is that generally speaking, we haven't had that separation. We've been able to maintain a large middle group that is able to keep going with the economy. Now I perceive, and your point about custom housing and to some extent vacation homes bears it out, a growing separation into a two-tiered economy.

Mr. WEBER. Well, that appears to be true here on the Eastern Shore. I'm not convinced that that same fact is true for the country throughout. I personally believe the Eastern Shore has been isolated for many, many years, and is now being broken open. And the people who want the low and medium-priced house, they want it just as bad as the people who want the luxury home. But unfortunately, what we see is 16 percent mortgage rate doesn't scare them, and $80,000 doesn't scare them. But when you put 16 percent on top of $80,000 and divide it by 20 years and come up with monthly payments, they are willing to pay it, but they don't have it.

That's the real problem.

Senator **Sarbanes**. Gentlemen, thank you very much. You've been a very helpful panel.

Larry, while you are here, because I know that some of the people you work with are in the room, I simply want to acknowledge the really excellent leadership you have provided the Watermens Association. I have had the opportunity to work with you on a lot of issues, and I must say that I think Maryland Watermen are very well organized. They are very careful in working out their positions, and they are very effective in finding solutions.

Mr. **Simms**. Thank you very much, Senator.

Senator **Sarbanes**. I think Mr. Weber's testimony leads right to Mr. Scott and Ms. Yates. We appreciate your patience and will be happy to hear from you. We are very pleased to have you here. If you have an order worked out, you may proceed.

TESTIMONY OF L. HAMPTON SCOTT III, DIRECTOR, CECIL COUNTY BOARD OF REALTORS, ELKTON, MD.

Mr. **Scott**. What I would like to do is to give a localized presentation, and provide a synopsis of my testimony for the record if I may and also, I am from Cecil County which, as you know, is on the upper end of the Shore, and Nancy Yates is from Chester, Md.

Senator **Sarbanes**. And of course, Hursey, is from Salisbury, which is my home town.

Mr. **Scott**. Mine is primarily going to be about Cecil County. And to start off with a statistic right away, our sales are down in Cecil County from this time last year and, in fact, from August of 1979, 37 percent. Currently, the average days on the market for multilist sales, we're at 135 days and in January to June 1981, we were 124 days, and in August 1979, we were 91.

The point I want to make on these figures is that generally a property is put on the multilist for a period of 3 to 6 months. Many of these properties that have been listed as 135 days on the market have previously been listed with another realtor, say, for a period of 3 to 6 months, and then they would go and be withdrawn for no sale, and still they would show up in the statistic after it was listed with another realtor as 135 days on the market, where in actuality, it could have been on the market for 280 days.

May I also point out the different rates that the 25-year amortization would cost. For instance, at 18-percent interest rates, monthly payment would be $637.56 on a $42,000 mortgage, approximately a $50,000 house, whereas, with 12-percent interest rates the monthly payment would be $632.40 on a $60,000 house. That would show that a decrease of 6 percent in the annual interest rates allows a person to qualify for 18,000 additional mortgage dollars and make approximately the same monthly payment.

Senator **Sarbanes**. The table in your synopsis very helpful. It shows the differing mortgage amounts and then the monthly charge for 12, 14, 16, and 18 percent. The $60,000 mortgage that you just talked about is $632 a month at 12 percent, and at 18 percent it goes up to $911 a month. That information is very useful.

Mr. SCOTT. It also shows the mortgage qualifications under the conventional guidelines of a $25,000 annual income with no debts and a 20-percent downpayment at the 18 annual interest rate, such as we have now, that would buy a $44,300 home with a $35,450 mortgage. And if you get down to 15 percent annual interest rate, that could buy a $52,500 home, with a $42,000 mortgage. And dropping it back down to 12 percent where we were only 2 years ago or less, that would buy a $63,800 home, with a $51,000 mortgage.

Senator SARBANES. In Cecil County, what kind of homes are we talking about at those prices?

Mr. SCOTT. What style house would you get for $60,000?

Senator SARBANES. Right. Or a $44,000 house?

Mr. SCOTT. A $44,000 house. For $34,000 to start out, we could sell you a townhouse. $40,000 will get you a development tract. Good quality, three-bedroom home with one bath. For $50,000 in Cecil County, we will sell you an individual lot, larger type development—I mean larger lot development, possibly a bilevel, a fairly decent house.

Senator SARBANES. Your prices are below the rest of the State; aren't they?

Mr. SCOTT. Probably some of the lowest.

The synopsis also shows the different rates that are available from the eight lenders that we have in the county, and this is a very recent survey, as of Friday. Of the eight lenders, two are already out of the market. You cannot get any financing at all. The lowest is 17 percent, as you see, with a 40-percent downpayment and 15-year payoff, and the highest is 18 percent plus 3 points for a 30-year payoff, and the highest is 18 percent plus 3 points for a 30-year payoff. And as you mentioned earlier, adding points into the purchase price of a home just stimulates the inflation.

Senator SARBANES. That's right.

Mr. SCOTT. The rental market also is affected. Many families are experiencing difficulty in buying their home in the current market. For this reason, the request for rental housing has increased. Some offices have been reporting up to five times as many calls for rentals as usual.

The number of rental units is decreasing because of the high-interest-rate loan mortgages for investment properties, and an investor cannot pay prime rate plus 2 percent and still rent at an affordable rate.

Speaking of drawing money out of the Treasury, as you were with the builders earlier, on the tax loss, the high interest rate on mortgages is causing taxpayers to have high deductions for interest paid on their home mortgages. These deductions are causing both Federal and State governments to lose many thousands of tax dollars.

A $40,000 mortgage at 18-percent interest has an income tax deduction of $433.33 a month a tax savings of $122.33 a month. A $60,000 mortgage has an income deduction of $645.00 a month, and yields a savings of $180.60 a month. These quotations are based on the homeowner being on the 28-percent tax bracket.

Senator **Sarbanes**. That's an interesting point.

Mr. **Scott**. My report is localized as far as reporting what we did, as you see.

And, of course, this was State legislation, but in December of 1980, our county sold $15 million worth of tax-exempt municipal revenue bonds. Our county did not pledge to full faith and trust for these funds, as the mortgages granted under this program insure the bonds' repayment.

We were able to put out, through seven local banks and one mortgage company, $12.5 million worth of single-family-home mortgages. Although all of the homes have not as yet gone to settlement, this money has all been committed. This affordable mortgage money was a boost to the entire community.

Perhaps the current Federal legislation regarding and restricting the issuance of these bonds for home mortgages should be reviewed and relaxed until our economy becomes more stable.

In addition to that, I mentioned, earlier, we were down 37 percent from last year. I can't imagine where we would be if we didn't have the bonds to put $12.5 million worth of financing for residential homes.

Senator **Sarbanes**. So the 37 percent takes into account what you've gotten from those bonds?

Mr. **Scott**. I could imagine very much that we would be 50 percent worse.

Senator **Sarbanes**. You used the $25,000 annual income in this example over here. Do you have any idea what percent of the families in Cecil County have a $25,000 income?

Mr. **Scott**. Less than 5.

Senator **Sarbanes**. Less than 5 percent?

Mr. **Scott**. Let me correct that. Less than 10 percent——

Senator **Sarbanes**. This is a figure well above the national median, and I wondered—since that's the example you were using and that is how you were relating these housing costs—what percent of the people you might be talking about. You figure about—less than 10 percent?

Mr. **Scott**. Yes.

Senator **Sarbanes**. Thank you. This is very helpful material.

Mr. **Scott**. Incidentally, I also have a few charts.

Senator **Sarbanes**. If you could submit those charts [1] and the synopsis we will include them in the record.

[The synopsis referred to follows:]

SYNOPSIS OF THE TESTIMONY OF L. HAMPTON SCOTT III

MULTILIST STATISTICS

August sales down 37 percent from August 1979 and 1980.

Average days on the market for multilist sales

Current	135
January–June 1981	124
August 1979	91

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[1] Due to a three color display, the charts referred to by Mr. Scott may be found in the committee files.

COMPARATIVE MORTGAGE PAYMENTS

Interest (percent)	Monthly payment	Mortgage
Fixed rate mortgage—25-year amortization:		
18	$637.56	$42,000
12	632.40	60,000

A decrease of 6 percent in the annual interest rate allows a person to qualify for $18,000 additional mortgage dollars and make approximately the same monthly payment.

Mortgage amount	Percent			
	12	14	16	18
$35,000	$368.90	$421.40	$475.65	$531.30
$42,000	442.68	505.68	570.78	637.56
$60,000	632.40	722.40	815.40	910.80
$75,000	790.50	903.00	1,019.25	1,138.50
$100,000	1,054.00	1,204.00	1,359.00	1,518.00

MORTGAGE QUALIFICATIONS UNDER CONVENTIONAL GUIDELINES

	No debts	20 percent downpayment
$25,000 annual income:		
18 percent annual interest rate	[1] $44,300	[2] $35,450
15 percent annual interest rate	[1] 52,500	[2] 42,500
12 percent annual interest rate	[1] 63,800	[2] 51,000

[1] Home. [2] Mortgage.

MORTGAGE MARKET—CECIL COUNTY LENDERS

First National Bank of North East—17 percent, 30 percent down, customers only, 3-5 year renewable term.

First National Bank of Maryland—17½ percent plus 3 points, 30 years.

County Banking & Trust—Adjustable Rate Mortgage 17 percent, 40 percent down, customers only.

Equitable Trust Company—17½ percent plus 2 points, 30 years, 20 percent down, no construction loans.

Atlantic Federal S. & L.—Out of market.

Cecil Federal S. & L.—Out of market.

Loyola Federal—18 percent plus 3 points, 3 year extendable balloon, 30 year amortization, 95 percent financing (¼ percent PMI as required).

Peoples Bank of Elkton—17 percent, 40 percent down, 15 years.

FHA/VA—16½ percent plus 7½ points (FHA insurance additional ½ percent).

RENTAL MARKET

Many families are experiencing difficulty in buying their first home in the current market. For this reason, the request for rental housing has increased. Some offices are having up to five times as many calls for rentals as usual. The number of rental units is decreasing because of the high interest rate on mortgages for investment properties. An investor cannot pay prime rate plus 2 percent and still rent at an affordable rate.

TAX LOSS

The high interest rate on mortgages is causing taxpayers to have high deductions for interest paid on their home mortgages. These deductions are causing both federal and state governments to lose many thousands of tax dollars. A $40,000 mortgage at 18 percent has an income tax deduction of $433.33 and a tax savings of $121.33. A $60,000 mortgage has an income tax deduction of $645.00 and yields a savings of $180.60. These quotations are based on the homeowner being in the 28 percent tax bracket.

MORTGAGES FUNDED BY TAX EXEMPT MUNICIPAL REVENUE BONDS

In December of 1980, our county sold $15 million worth of tax exempt municipal revenue bonds. Our county did not have to pledge full faith and trust for these bonds as the mortgages granted under this program insure the bonds repayment.

We were able to put out through seven local banks and one mortgage company $12.5 million worth of single-family home mortgages. Although all of the homes have not as yet gone to settlement, the money has all been committed.

This affordable mortgage money was a boost to the entire community. Perhaps the current federal legislation regarding and restricting the issuance of these bonds for home mortgages should be reviewed and relaxed until our economy becomes more stable.

Senator **Sarbanes**. Ms. Yates.

TESTIMONY OF NANCY K. YATES, REALTOR, CHESTER, MD.

Ms. **Yates**. I don't have much else to say, except our county is much more rural than Cecil County. And our low-income housing here would run around $32,000 to $42,000, which means they would come under Farmers Home.

Last month, in August, Farmers Home did not get the money they were supposed to, so we have several settlements pending.

Many of our people are leaving the industry. I have part-time salesmen, but they can't earn the money. And I think a lot of the companies, too, are merging with other companies, which isn't the most appealing thing for a person after they have worked their life to build up their own business. And it has happened to several friends of mine, especially on the Western Shore.

Senator **Sarbanes**. How much are the owners now taking paper in the sales that you're involved with?

Ms. **Yates**. Very few of ours here, because if they are moving, they're leaving the community and they need their equity. I've got one home where the man wants to move to Florida; it is a waterfront home. I had another client call this morning and say she's thinking of putting her home on the auction block, and it is a marketable home; but the interest rate at the local banks is 18 plus, too. And Loyola is just about out of it, and that is where we got a lot of our financing.

Senator **Sarbanes**. We had some figures—and I don't have them right at my fingers—from the Loyola Federal vice president yesterday. The drop they have experienced is really staggering.

Mr. **Scott**. Twenty-one percent on our county, as far as the owner takebacks.

Senator **Sarbanes**. Now much of that is going on? Are you involved in all of these new developments—what is now put under the heading of creative financing?

Mr. **Scott**. Yes, you have to.

But a comment on that—and we had a man here from the Federal Land Bank, and I have a loan with the Federal Land

Bank. This is just a personal comment, but it can show you what can happen, that you can get in trouble with a variable-rate mortgage, because when I started out, it was a 10-percent loan, back in 1979, in December, and my payment was $482 a month. And now it has gone to 13, which is fantastic if I was trying to sell, 13 percent financing. But I was geared into a $482-a-month payment, and now my payment has gone to $585 a month, which is $103 more per month. And I'm not making money in the real estate business that I was back in 1979 either.

Senator SARBANES. So you're caught both ways.

Mr. SCOTT. Yes, you are caught both ways.

Senator SARBANES. Are the builders in this area buying in the interest for a period of time in an effort to try to move their houses?

Ms. YATES. A lot of realtors were buying in, and they will offer a lower rate. So, therefore, it was an inducement for people to go ahead and list their property or go to them, because they were getting financing. But I think that has almost come to a halt.

Mr. SCOTT. I would agree with that.

Senator SARBANES. What about people who have to move because they work for a company and get transferred out of the area? What is their situation?

Ms. YATES. We just had someone do that here in the area, and Home Equity bought their home below market value, and he had to do it. He said he had to, to get the money to go finance another home in Wilmington.

Mr. SCOTT. My comment on that would be that generally, on those type of transfers, we are dealing in our area, which is a higher dollar value, of $80,000 to $100,000 property. And it is no great problem, just as the builder said, when they get into the higher dollars, that the potential homeowner has the money. But the slower to middle in our area is the problem.

Senator SARBANES. Do you find that companies—this would really be the larger companies--provide special programs for their own people, or for the people they are trying to attract? Do you have very much of that?

Mr. SCOTT. Yes, the corporate transfer companies will come in with two or three appraisers and will appraise it. And in our area, the will pay them what the appraiser says it's worth. Hopefully, you can get a decent appraiser, but they also ask you on the appraisal form—and I do appraisals—the expected market time, 30 to 60, or 0 to 30, or over 60. And these statistics show 135 days or more.

Senator SARBANES. Of course, the smaller companies can't generally offer that benefit. So they are at a disadvantage in trying to recruit top-level management personnel.

Well, thank you all very much. You have been a very helpful panel.

As I said, Hursey Porter made a very helpful statement this morning, and I know the interaction within the National Association of Realtors has been very important.

We had invited Joe Quinn to come; and I wasn't certain he would be here, so he's not on the program. But I see he is here.

Joe, we would be happy to hear from you. I know your own line of work gives you an outside perspective on all of these problems.

STATEMENT OF JOSEPH D. QUINN, CERTIFIED PUBLIC ACCOUNTANT, CENTERVILLE, MD.

Mr. QUINN. Thank you, Senator.

As a fellow Democrat, I would like to commend the Senator from the Eastern Shore, who has voted to support the President's Economic Recovery Act. And now some of the problems we're attacking are these directly, and one of these being the interest, as well as looking at the inflation factor.

In my profession as a CPA, a partner in a firm that audits companies here in the mid-shore area, we are exposed to many facets of the business and individual economic areas of development here on the Shore.

And I would like to cover some of the impacts of these particular industries with you to give you some ideas and possibly some things that you should consider to be some of the solutions to the high interest problems, one industry being the banking industry.

With the deregulation consideration certainly being considered now, the high competition that they are having from the money market funds and the U.S. Government, in particular, competing for the money funds has driven up a lot of the interest rates, I feel.

And the U.S. Government demand for the borrowings that are continually—you are reading about every week—having to go into the Treasury and borrow large sums of money, is forcing a lot of the small savers that used to put their money in E bonds and H bonds to cash many of those in where they can receive higher interest.

So, the banking industry is certainly—here on the Shore, a lot of our small banks, in the deregulation process, they are facing competition for the dollars which they put back into the community.

Now, I know of many of our clients that have invested large sums of money in the money market funds that have given them a high rate of return, but these funds are not coming back to the Eastern Shore in the form of investments to the housing industry to support our various employers on the Shore that are providing jobs here.

Another industry that we audit is the governmental industry, which are the counties and towns. There are a lot of large capital projects that cost many, many millions of dollars, in the water area, the sewer area, in our roads and bridges. And the high cost of obtaining the funds in the bonding market and the grants are slowing up the process in that area. That is directly affecting us here on the Eastern Shore.

Another area is our food processing industry here on the Shore. Whereas it costs many millions of dollars to finance the high inventory and accounts receivable cost of business today, that most of our businesses here on the Shore are not large enough to have the capital and the wherewithall to finance that, and they have to look to the financing sources to obtain that.

So, we are adding high interest costs of 18 to 20 percent rates that have become a constant here in the last 6 to 8 months, that are being included right in the food cost that is going out to the various markets.

In our farm machinery dealers and auto dealers, the floor plan and financing their inventories and receivables, the high cost there.

Our real estate developers that are developing and our contractors that have investments in land that they can't sell now and lots, because people can't afford to build homes. And you have contractors that don't have people that are willing to pay these prices.

So, it seems to be a continual cycle in this business community in the mid-Shore area, that the impact of the high interest cost is affecting us all.

And I think some of the areas that I know that you have probably heard a lot of the complaints of what this is doing, but I think—I don't know whether you have heard any solutions to the answer yet to find this, to put all these complaints together.

But I think that we do want to compete here on the Eastern Shore under a free enterprise system. But I think that the U.S. Government, of which you are a part, is playing a very big role in causing these high interest rates.

And I think if you look to the Government side and the bond market and their impact, and look at the money market funds as it relates to taking away funds from our local banking and savings and loan institutions here on the Shore, I think you will probably find some answers there.

So, thank you very much for giving me the opportunity and the time to spend with you.

Senator SARBANES. I appreciate that testimony very much.

And I want to say to everyone who has testified, and those who have attended, that I think this has been a very helpful hearing.

It is my own view that the premise upon which we are proceeding has to be changed as a starting point. I disagree with the Chairman of the Federal Reserve when he says, as he did on Sunday, that people will simply have to suffer through this period. My perception is that established, efficient, able, productive people are simply not going to be able to suffer through it. In other words, we have reached a crisis point where those who have made and are continuing to make an important economic contribution are being pushed under.

The premise has to be changed—we have to say, "That must not happen," we're not going to allow that to take place, and we will make other changes that may be necessary.

As I said, I think the present policy—and as was said by a number of the witnesses today—is really counterproductive. It is contributing, in many instances, to the very problem which its defenders assert it is designed to address.

I want to thank everyone who has participated in the hearing and taken the time and the effort to come and be with us.

The subcommittee stands in recess.

[Whereupon, at 4:20 p.m., the subcommittee recessed, to reconvene at 9:50 a.m., Wednesday, September 2, 1981.]

EFFECTS OF HIGH INTEREST RATES ON MARYLAND COMMUNITIES

WEDNESDAY, SEPTEMBER 2, 1981

CONGRESS OF THE UNITED STATES,
SUBCOMMITTEE ON INVESTMENT, JOBS, AND PRICES
OF THE JOINT ECONOMIC COMMITTEE,
Washington, D.C.

The subcommittee met, pursuant to recess, at 9:50 a.m., in the Lobby Auditorium, Executive Office Building, 101 Monroe Street, Rockville, Md., Hon. Paul S. Sarbanes (member of the subcommittee) presiding.

Present: Senator Sarbanes.

Also present: James K. Galbraith, executive director; William R. Buechner, professional staff member; and Betty Maddox, assistant director for administration.

OPENING STATEMENT OF SENATOR SARBANES, PRESIDING

Senator SARBANES. Good morning. This is the third day of hearings of the Subcommittee on Investment, Jobs, and Prices of the Joint Economic Committee that we are conducting to examine and document the effects of high interest rates on Maryland communities and our citizens.

Earlier this week, we heard graphic descriptions from a wide variety of business and local leaders concerning how high interest rates have hurt local economies—in Baltimore County; yesterday morning, we were in Annapolis, where we heard from the Governor and other business leaders in that locale; and in the afternoon, we were over on the Eastern Shore, where we heard some very significant testimony, in my judgment, from the farm community.

Today, the subcommittee opens this hearing in Rockville to review the impact of high interest rates in this area. In six separate hearings this week, we will hear from more than 80 witnesses about the severe challenge of high interest rates, a challenge which these witnesses know best since they face it daily in their own economic acitivity.

I think it is no exaggeration to say that the problem created by continuing high interest rates is approaching crisis proportion. The situation this year, with the prime at the levels at which we find it, is unparalleled.

During the last 12 months, the prime rate has been at 21½ percent. Today it remains at 20 percent.

The mortgage rate in many financial institutions is over 17 percent, the highest it has ever been.

The interest rate on tax-free municipal bonds is at 11 percent, more than double the figure local governments had to pay only 4 years ago.

These rates have created grave obstacles to the operations of many established and productive enterprises, particularly in those sectors of the economy which depend upon credit—upon a line of credit for their economic activity.

The damage thus far is serious and if conditions ae not soon improved, will be irreparable. Enterprises which have been an important asset to their respective communities—enterprises which have really been an essential part of the economic base will be lost.

The burden of high interest rates has become a major financial problem for small businesses. Auto dealers and other sellers of consumer durables have been particularly hit.

For the first time in the history of the quarterly survey by the National Federation of Independent Businesses small business rank interest rates and financing as the single most important problem facing them.

The survey, which was released last week, stated, and I quote: "The currently high rates of interest are making a bad situation unbearable for many small firms."

Last year, almost 12,000 businesses fell nationwide, the highest figure in more than a decade and almost double the figure in 1978, when interest rates were only half their current level.

The situation is particularly critical in the homebuilding industry. Housing starts last month stood at an annual adjusted rate of just over 1 million, down 17 percent from the already-reduced pace of a year ago, and only half of the 2 million starts needed to meet nationwide demands.

Construction-related industries find themselves depressed, with unemployment in the construction industry running at 15 percent, twice the industrial average.

Home sales have fallen dramatically, down in Maryland as much as one-third—yesterday we heard one-half—from the levels of 2 years ago.

With mortgage rates now around 17 percent, purchase of a median-priced house in the national capital area, for example, would require an annual income of well above $50,000, which, of course, is an income held by only a fairly small percentage of our families in this country.

Financial institutions, particularly the savings and loan associations, small banks in the rural areas of the country, many of which have done so much to make home ownership a reality, face unprecedented pressures.

High interest rates have very serious implications for the finances of state and local governments.

Sunday's New York Times had an article which stated, and I quote:

> These these are dark days for State and local treasuries * * * Prices of municipal bonds have been sliding all year and fell to a historic low last week. At the same time, the interest rates the governments have to pay on their new bonds have reached historic highs.

This is an especially serious blow at a time when State and local jurisdictions must look forward to sharp reduction in Federal support.

The Federal Reserve Bank in Richmond reports that Maryland farmers—and we heard extended testimony yesterday on this subject—are now paying the highest interest rates they've ever had to pay for bank loans.

There are many farmers paying 2 to 3 percentage points above the current prime rate. As a result, farmers across the State, as elsewhere in the Nation, have been postponing or abandoning productive investments which would make them more efficient and effective producers.

The purpose of these hearings is to document across the State, with testimony from the those directly affected, the conditions to which these statistics attest.

Over the past 18 months, the Joint Economic Committee, created by the Employment Act of 1946 to provide Congress with economic information and advice, has held a number of hearings on the interest rate question. And we will return to this matter when the committee, in the fall, begins its examination of the impact of the recently enacted economic programs.

It is my expectation that the record of the Maryland experience established by these hearings will make an important contribution to the committee's work, to the deliberations of the Congress, and to the response which policymakers must undertake to remedy this pressing economic situation.

We are very pleased this morning to have, as our leadoff witness, the very able county executive from Montgomery County, Charles Gilchrist.

If you will come forward, we will be very happy to hear from you, Mr. Gilchrist.

I also want to acknowledge the presence of Ruth Specter, who is the president of the Montgomery County Council.

We are very pleased that you're here with us, Mrs. Specter.

STATEMENT OF CHARLES W. GILCHRIST, COUNTY EXECUTIVE, MONTGOMERY COUNTY, ROCKVILLE, MD., ACCOMPANIED BY WILLIAM H. TREWORGY, DEPUTY DIRECTOR, MONTGOMERY COUNTY BUDGET RESEARCH OFFICE

Mr. GILCHRIST. Senator Sarbanes, thank you very much for holding the hearings in our county. We think they will be productive and informative.

I want to discuss this situation. You have my prepared statement, so I won't read it.

Senator SARBANES. Your prepared statement will be included in the record, Mr. Gilchrist.

Mr. GILCHRIST. Thank you.

I want to discuss the impact of the interest situation in two very vital respects:

First, its impact on the county government as a borrower, and thereby on our citizens, as taxpayers and as people who want to live in a growing and vital community.

And second, I want to talk about the impact, as we perceive it, on the county's economic base and the county as a community.

Mr. Bill Treworgy, who is the deputy director of our Budget Research Office, is here with me.

You indicated that the impact of this situation is great even on organizations and on businesses that are well run. We think we fall within that category. Montgomery County has one of the few AAA ratings on its bonds. It is considered to be an extremely favorable rate.

Earlier this year, the county, which has the highest possible credit rating, sold its bonds at what was considered to be favorable. That rate was 8.91 percent. To do this, we had to scale back the terminal loan from 20 years, our traditional level, to 15 years.

I would like to show you just one chart. We won't trouble you with the others. But we have prepared a chart which shows the term of years—the total terms of years in total dollars borrowed, the date of issue, the total interest over the life of the loan, first year's interest, total payments, and so on for various bond issues.

To understand the significance of these figures, we have included, for example, what we would have paid back in March 1981 if our bond rating had slipped, just a little bit, to the AA status.

Exhibit 1 in my prepared statement shows that the figures at the March 1981 levels, as compared to what we actually paid for credit 5 years ago, in 1976, which was 5.16 percent; just 2 years ago, 5.9 percent; and what we paid 10 years ago, which was 4.31 percent. So we actually paid more than $6 million in interest in 1981, just to borrow $70 million. And we had to pay the State more than $10 million over that 12-month period to redeem this debt, which includes interest and payments on principal.

Had the rates been what they were just 5 years ago, the cost of borrowing would have been $3.6 million rather than $10 million in the first year. The same transaction 10 years ago would have cost just $3 million, half of what we have to pay this year in interest.

On the other hand, if we had not had the AAA rating—which we are very glad that we do—it would have cost us a quarter of a million dollars for that difference alone.

And you can imagine how many governments in this country are finding it unable to sell their bonds at all because of the failure to make that kind of premium payment.

Now, to retain this AAA rating, we have had to take some very serious steps to restrain our budget. For example, we have a chart which will reflect a sharp increase in our effective property tax rate in recent years and also which will show the fact that, adjusted for inflation, our property tax rate has, in fact, declined.

We have charts that indicate these facts, but that doesn't mean that costs of Government have gone down because of the impact of inflation and that impact particularly driven by the rate of the bond market. Even with the measures that we take toward restraint, the trend is still extremely distressing.

Lest you conclude that the increases in the cost of borrowing have been over a 5- or 10-year period, let me point out the fact that the lowest price in 1979 quoted by the bond buyer was 5 percent. Just a week before last, the quoted price for average municipal bonds was 12 percent.

So, we're not talking about a trend that is accelerated over a 5- or 10-year period; we're talking about a matter of 2 or 3 months.

We have just witnessed 11 consecutive weeks of increases in high interest rates to be paid municipalities; you alluded to this earlier. Seven of them have been the record high. In fact, the increase between 1979 and 1981 cost the county more that $2 million in interest payments in the first year of the bond's life, and we expect this trend to continue.

We are required to float a bond issue of $85 million this coming winter. Among the things we consider doing there is to cut back on our lending program. To a great extent, that's impossible because we have planned carefully for the growth of our capital structure, and it would be impossible to limit it.

But even in the limited extent that we can cut back our capital program, we are faced with the "Hobson's Choice," because the projects are needed, not only to meet health and safety costs, but also the economic development goals which underwrite our tax base.

Unfortunately, we do not anticipate any interest rate reduction, for reasons that you have outlined. What I have outlined so far is the impact on the county government and its taxpayers, as an entity, in meeting our commitments for appropriate capital structure and the requirements that that has placed upon us for even greater fiscal restraints and even greater failure to meet the legitimate needs of our community.

But let me speak briefly about the impact on the community, which is depending on an expanding private sector, which is also hurt by high interest rates.

Our housing is in very tight supply. Mortgage rates here, as elsewhere, are so high that sellers often cannot dispose of houses without taking a portion of the selling price back as the mortgage. This means that turnovers are slower.

And with high interest rates, net sales are declining; the cost of money to builders depresses construction, with an inevitiable inflationary impact on housing stock. This hurts not only the would-be homeowner and renter, but also employers, because they must subsidize key personnel if we expect them to move here from other areas.

One such company, for example, in New Jersey estimated that it costs between $30,000 and $40,000 to buy out just one low-interest income—low-interest home mortgage there in New Jersey and then underwrite a higher mortgage here. This kind of expenditure deters locations in Montgomery County.

We attract high technology industry, including corporate headquarters and scientific and technological headquarters. These are capital-intensive businesses because their equipment, their wares are custom-designed and reflect current investment and expenditure. They're much more vulnerable to high interest rates.

Our estimate is that 80 percent of our new jobs come from facility expansion here in the county. And we're often told, and we're well aware, of cases in which our industries have postponed substantial expansion because of high interest rates.

In fact, there has been one very major investment in the Gaithersburg area which was to take place and which has not taken place, has been postponed because of the fact that interest rates are simply too high. And that affects, as you indicated earlier, the number of jobs in our county, the opportunities for those of who want to be employed in these high technology industries to do so.

We are no longer a bedroom community in this county. In the past 5 years, we have reached the point where more than 60 percent of our work force is employed in the county.

And equally important, at a time when the Federal Government is declining, for example, by somewhat over 2 percent or about 2 percent this year, the county government is being reduced in terms of the number of employees that we employ.

We are depending on expansion in the private sector; and we are, in fact, expanding. We expect a 6-percent private sector increase in employment this year. But in order to have that healthy shift from government to private employment, we must have the opportunity for these businesses that want to expand to expand.

Now, I don't know what the solution is. That's not my job. I have enough trouble facing the problems that we have tried to outline to you this morning. I leave the solution to you. But we see high interest use as a means of fighting inflation.

And I must say, like you, that, paradoxically, it seems to me that it's probably feeding the very disease that it is designed to combat. It's possible that initiatives that are required to bring down interest rates, would bring other highly undesirable side effects; we don't know. But we do know the injury to Montgomery County, which must borrow to provide essential facilities, and the danger to our expanding private sector, which needs capital improvement, the danger for this situation.

We are curtailing borrowing to the extent we can. We are squeezing our programs. But these efforts have limits of success. Unless the interest rates are brought under control soon, Montgomery County faces special injury. We are working toward reducing that injury, but we cannot stand against that rising tide indefinitely.

Thanks very much for this chance to share our views with you.

[The prepared statement of Mr. Gilchrist, together with attachments, follows:]

PREPARED STATEMENT OF CHARLES W. GILCHRIST

Thank you for the opportunity to describe the impact of high interest rates on Montgomery County, first on the County government as a borrower and then on the County as a community. This County must borrow money to pay for roads, waste treatment facilities, schools, libraries, and other improvements. The interest rates we must pay increase as other interest rates increase. It is true that the tax-free status of our bonds and our excellent credit rating mean we pay less than do builders or other private borrowers. Nonetheless, the mounting costs of borrowing distort the County's budget, and sharply increase the burden on our citizens.

Earlier this year the County, which has the highest possible credit rating—AAA—sold its bonds at what was considered to be a "favorable" rate—8.91 percent. To do this, we had to scale back the term of the loan from the traditional 20 years to a shortened period of 15 years. I have prepared a chart reflecting the term of years, total dollars borrowed, the date of the issue, the total interest over the life of the loan, the first year's interest and the first year's total payments for various bond issues. To help comprehend the significance of these figures, I also included what we would have paid in March 1981 if our bond rating slipped just a little—to AA status. This chart, Exhibit I, shows these figures at the March 1981 levels, as compared to what we actually paid for credit five years ago, July 1976 (5.16 percent); 2 years ago (5.56 percent); and what we actually paid 10 years ago, November, 1971 (4.31 percent).

As this chart shows, we actually paid more than six million dollars in 1981 to borrow seventy million dollars. We had to pay out a shade more than 10 million dollars over these twelve months to redeem this debt and its interest. Had the rates been where they were five years ago, the cost of borrowing would have been $3.6 million dollars the first year. The same transaction, ten years ago would have cost a shade over 3 million dollars, half of what we have to pay this year. On the other hand, if we lost our AAA rating, it would have cost us more than a quarter of a million dollars in this year alone.

To retain our AAA bond rating, we restrained our budget and preserved a healthy surplus of revenues over expenditures. This reassured the rating agencies of our prudence in handling our resources. I have prepared Exhibit II which reflects our annual budget for the last ten fiscal years in constant dollars. This means the rate at which we would have spent if there was no inflation. As the chart shows, we went from $354.5 million budgeted for fiscal year 1980 down to less than 340 million in fiscal year 1982. To do this, we have restricted budgets to essential services and pushed our staff for maximum productivity. Indeed, our workforce as reduced during fiscal year 1981 by 232 employees and we have targeted a reduction of another 100 in fiscal year 1982.

I have also prepared Exhibit III which shows the actual effective property tax rate in this County for the last few years. This is derived by taking the de facto assessment in terms of actual market value of a house and using this in evaluating the impact of the tax rate. It shows that we have been able to bring the effective rate down from $1.36 per $100 of market value in 1978–79 to $1.05 per $100 in 1980–81. This does not mean that the tax bill for the average houseowner declined; inflation had the opposite effect. What it does show is that by operating at less than inflation, the County has been able to reduce the magnitude of its tax bite on its citizens. This history obviously helps us to secure a bond rating that temporizes the rate at which we have to pay for bond borrowing.

Even with these measures the picture is bleak and the trend is distressing. Lest you conclude that the increases in the cost of borrowing have occurred over 5 or 10 years, you have to look back only two years. The lowest 1979 price quoted by Bond Buyer was 5.77 percent. On August 20, 1981, the week before last, the quoted price for average municipal bonds was 12.49 percent.

We have just witnessed 11 consecutive weeks of increases in interest rates to be paid by municipalities, seven of them each a record high. In effect, the increase between 1979 and March 1981 cost the County more than two million dollars in interest payments in the first year of the bond's life. This coming winter, we are scheduled to float 85 million dollars in bonds. Based on last week's figures, this would cost us over 5 million dollars more in the first year than if we had sold them in 1979.

To avoid raising property tax rates we may have to cut back some scheduled capital improvements (to the limited extent that is possible given our commitments). This action is a "Hobson's Choice" because the projects are needed to meet not only health and safety needs but also the economic development goals which underwrite our tax base. Unfortunately, we do not anticipate interest rate reductions. Inflation does not seem to be abating. Of even more direct concern to us in the fact that quick fix remedies, such as the new one year tax exempt instrument, will complete directly with municipal bonds.

What I have thus far described are only the direct fiscal problems high interest rates pose for the County government as a borrower. As a community dependent on an expanding and vibrant private sector, we also are hurt by high interest rates.

Our housing is in tight supply. Mortgage rates, as elsewhere in the county, are so high that sellers often cannot dispose of houses without taking a portion of the selling price back as a mortage. This means that turnovers are slower and, with the high mortgage, rate, net sales are declining and the cost of money to builders depresses construction—with an inevitable inflationary impact on existing housing stock. As a result, our housing costs grow rapidly. This hurts not only the would-be homeowner and renter, but also hurts employers that subsidize key personnel who are moved here from other areas. One such company in New Jersey estimated that it cost between thirty and forty thousand dollars to buy out just one low-interest home mortgage there and then underwrite a higher mortgage and closing costs down here. This kind of expenditure deters relocation to Montgomery County.

Montgomery County attracts high technology industry, including scientific and corporate headquarters. These are capital intensive because scientific and sophisticated office equipment is custom designed and newly on the market, not second-hand or readily rented. Capital-intensive industries are therefore, more vulnerable to high interest rates that impede relocation or expansion of such enterprises. Our estimate is that 80 percent of our new jobs come from facility expansion. We are often told by our industries of their postponement of expansions waiting for lower interest rates. In fact, they very high interest rates to be earned on money market funds, for example, have made corporate executive think twice about putting money in new plants and equipment when they can earn 17 percent just by lending.

Montgomery County is no longer a bedroom for Federal employees who sleep here and work in other jurisdictions. Within the past five years we reached the point where more than 60 percent of our workforce is employed in the County. This means that we must provide the infrastructure for employers—as we receive the taxes on improved realty and resident's income taxes.

A recent study or our economy projected that between June 1981 and June 1982, we would lose nearly 1 percent of the Federal jobs in the County. We plan also to reduce County government by 1.3 percent. Private sector jobs, however, will go up about 6 percent. This is a healthy position for our County—to rely on a vigorous private sector instead of public sector jobs alone. We are dependent, however, on the capacity of private employees to borrow capital to expand and relocate. High interest rates then are a special burden to a County like our's.

I do not know what the solution may be. We see high interest used as a means of fighting inflation. Paradoxically, it may be feeding the very disease it is designed to combat. It is possible that the initiatives required to bring down interest rates would bring other highly undesirable side-effects. I can tell you only of the injury to Montgomery County which must borrow to provide essential facilities and of the danger to our expanding private sector which needs capital for its developments.

We are curtailing borrowing to the extent we can. we are squeezing our programs to increase productivity and to defer capital expenditures. These efforts have limits of success. Unless the interest rates are brought under control soon, Montgomery County faces special injury. We are working towards reducing that injury but cannot stand against the rising tide indefinitely.

Thank you for this chance to share our views with you.

Attachments.

EXHIBIT I

BONDS

MONTGOMERY COUNTY INTEREST RATES

RATING	BOND ISSUE	TERM YEARS	INTEREST RATE .	DATE	TOTAL INTEREST	1st YEAR INTEREST	1st YEAR TOTAL PAYMENT
AAA	70,000,000	15	4.31636	11/71	24171619	3021452	7,688,118
AAA	70,000,000	15	5.1656	7/76	28927364	3615920	8,282,586
AAA	70,000,000	15	5.56	5/79	31136004	3892000	8,558,666
AAA	70,000,000	15	8.9145	3/81	49921207	6240150	10,906,816
* AA	70,000,000	15	9.3145	3/81	52161207	6520150	11,186,816
AAA	70,000,000	15	12.49	8/81	69944009	8743000	13,409,666
AAA	70,000,000	20	4.31636	11/71	31725246	3021452	6,521,452
AAA	70,000,000	20	5.1656	7/76	37967160	3615920	7,115,920
AAA	70,000,000	20	5.56	7/79	40866000	3892000	7,392,000
AAA	70,000,000	20	8.9145	3/81	65521575	6240150	9,740,150
* AA	70,000,000	20	9.3145	3/81	68461575	6520150	10,020,150
AAA	70,000,000	20	12.49	8/81	91801500	8743000	12,243,000

EXHIBIT II

MONTGOMERY COUNTY BUDGET HISTORY

YEAR	ACTUAL BUDGET (000,000)	BUDGETS IN* CONSTANT DOLLARS (000,000)	INCREASE IN CPI
FY73	323.7	323.7	---
74	361.7	336.5	7.5
75	417.0	346.3	12.0
76	454.9	356.8	5.9
77	479.7	356.9	5.4
78	526.4	363.8	7.6
79	579.2	368.4	8.7
80	615.8	354.3	10.5
81	678.8	347.0	12.5
82	730.4	339.6	10.0 est.

11/72 = 100

September 1981

EXHIBIT III

HISTORICAL ANALYSIS OF TOTAL WEIGHTED RESIDENTIAL STATED AND EFFECTIVE MONTGOMERY COUNTY PROPERTY TAX RATES

FY 1973 - FY 1981	Total Stated Weighted Average Property Tax Rate (Per $100 of Assessed Value)	Sales/Assessment Ratio	Total Weighted Average Effective Property Tax Rate (Per $100 of Market Value)
1980 - 81	$ 3.44	30.5	$ 1.05
1979 - 80	3.40	36.0	1.22
1978 - 79	3.77	36.0	1.36
1977 - 78	3.92	45.7	1.79
1976 - 77	3.91	43.8	1.71
1975 - 76	3.97	44.1	1.75
1974 - 75	3.63	48.2	1.75
1973 - 74	3.52	49.2	1.73
1972 - 73	3.58	52.9	1.89

The total weighted (by each Special area or municipality's assessable base as a percent of County-wide) average effective property tax rate has fallen from $1.89 per $100 of market value in FY-73 to $1.05 per $100 of market value in FY-81. This primarily reflects the rollback in the assessment level of residential property from 60% to 50% (fully effective in FY-76), from 50% to 45% in FY-79, and the first year (FY-81) of the Beck Bill which returned the State to a triennial assessment cycle phased-in one-third each year. Stated rates reached their peak in FY-76–FY-78 -- the FY-81 rate is only 4% lower than the FY-73 rate.

Senator SARBANES. Thank you very much. That was a very thoughful effective statement.

Let me ask you this question. Has the 20-year period historically been the term for which the county has gone out on its bonds?

Mr. GILCHRIST. For some time it has been. But you'll see, in exhibit 1 of my prepared statement, a listing of the terms of years of various bond issues. Perhaps Bill could contribute to that discussion of the term of the loan.

Mr. TREWORGY. For the last 20 years, we have been issuing 20-year bonds. This past winter was the first time that we have gone to a 15-year bond.

Senator SARBANES. That was done solely, I take it, in an effort to get a more favorable interest rate?

Mr. TREWORGY. Yes, sir.

Senator SARBANES. As I understand this table, your calculations are that you paid more than $3 million this year to borrow than you would have paid 10 years ago at the existing rates; is that correct?

Mr. GILCHRIST. That's right, $6 million as opposed to $3 million, approximately.

Senator SARBANES. What does that mean on your tax rate?

Mr. TREWORGY. One penny is equivalent to about $1 million dollars. So, an additional 3 cents on the tax rate is the consequence of the high interest rates.

Mr. GILCHRIST. Let me reemphasize that that's a 10-year period. We're talking about a difference between 8 percent and 12 percent just in a 1-year period. So, that's a 50-percent increase in the interest rate in less than a 12-month period if, in fact, we were to issue bonds today and if, in fact, the AAA rate were approximately 12 percent, which they have been estimated that it is.

Senator SARBANES. I think that's the point you make in your prepared statement is a very important one, that is that this change has come about with really dramatic speed. As you point out, on 1979, you had a bond price as low as 5.77 percent.

Now you're talking about 12.49 percent as the average on municipal bonds. That's an incredible jump in a very short period of time.

Mr. GILCHRIST. Let's say that we want to curtail our program. There's only so much that you can curtail. You can't stop a road that's in the middle of construction, where contracts have been let and plans have been made. And that's the kind of inequitable and extremely harmful impact that this roller coaster has gotten us on.

Senator SARBANES. What about the reverse side of that, the curtailing of a number of your capital improvement programs although it may be inefficient and wasteful in cost terms, because it means either continuing with an inefficient operation or not establishing the necessary infrastructure which the private sector needs to relate to?

Mr. GILCHRIST. Absolutely. I thing the best example of that is the most telling one for this reason—is the Metro System.

As you say, there has been substantial planning done and development on the drawing boards and underway based on assumptions about the completion of the Metro rail facility. And if that is changed, the impact on this county, on this region, would be devastating.

And I indicated to you also, for example, the impact in the area of Shady Grove, which is a very high-level economic asset for this county, of the failure to move ahead promptly on needed roads there that will make that facility work and enable it to expand—it's a very substantial economic development—we anticipate that we will be losing some $40 million in potential tax base over the next short period to time, a year or two, if we're not able to complete those roads. And yet, under the present status of funding of road projects, in large measure attributable to the costs of borrowing money, we have to face that prospect.

Senator SARBANES. What is your thinking as you look ahead, with respect to the $85 million in bonds that you have scheduled to float this coming winter?

Mr. GILCHRIST. Well, we see almost no way in which we can reduce the need to float that borrowing—again, because of the fact that we have construction projects that are underway and we have a need for cash flow to pay for them.

Now, perhaps we could adjust, to some extent, the period for the issuance of those bonds. We might have to consider—though we shrink from doing it—the issue of short-term paper, in hopes that the interest rate would improve.

But I think, based on prudent advice that we have, that there is almost no alternative for us than to go forward with that borrowing. And I think that we will have to do that.

We simply are depending upon you and others to make this point known at whatever level is necessary to have it understood that we simply cannot continue with this kind of "Hobson's Choice."

Senator SARBANES. That's an interesting point. I take it that you are saying that you have squeezed and tightened to the limit—that you have reached the point where you have no more room to distinguish between what you absolutely must do and what might be deferred. You really are down to the list of the things that must go forward.

Mr. GILCHRIST. We think that's true. The charts in my prepared statement show the restraint that we've exercised, and we're very proud of it. And we think Government should be restrained and should be tight. We intend to continue that.

But we feel the fact that we have a AAA rating, which is reflective of management, is reflective of the strength of the economy of the county, demonstrates that we're not profligate. We're not spending money that needn't be spent, because a strong community has to plan its expansion. It has to plan the infrastructure that will support that strong economy.

Therefore, we have a program that is necessary, that we have been committed to and which is underway. And it's impossible for us to react in a roller coaster way to changes of this sort.

So, yes, the answer is there is a limit to how much we can adjust those plans that we have made to continue the strength of this county.

Senator SARBANES. I want to concur in the evaluation of the fiscal prudence with which the county's financial affairs have been conducted.

Perhaps we should put your exhibit II[1] on the screen for a second; because it goes very much to the point I was making at the outset—that really effective and imaginative and efficient institutions, whether in the private sector or Government, are now being impacted severely even though they've done an incredibly good job of management.

Mr. GILCHRIST. You see, in the far right-hand column, the increase in the CPI that has occurred each year.

Then, In the left-hand column, you'll see the actual budget.

Senator SARBANES. Just in dollars?

Mr. GILCHRIST. In dollars.

The middle column shows the budget in constant dollars, which is adjusted for inflation. And you'll see a very sharp reduction since 1979 in those constant dollars.

Now, we like to tell people about that. And we think it's important. And it is important in terms of management. It is important in terms of our AAA rating. But it isn't of crucial significance to the taxpayers, because you'll see that because of inflation, much of which, through debt service, reflect interest rates—in fact, the actual budget is increasing inevitably.

But we feel that we have done a good job of restraining the growth in our budget, of cutting back the number of our employees by over 200, with plans to do even more in that respect, and in having the tightest, most productive county government that we can. We think our bond rating reflects that.

And still, even with that performance, our interest rates face the kind of increase that require adjustment.

Senator SARBANES. Do you know what term you expect to go back on these? I guess you're waiting to evaluate that under the circumstances.

Mr. GILCHRIST. Yes, I want to consult our financial director on that, Mr. Goff, too, and have him keep me informed on that.

Senator SARBANES. Thank you very much. I think this has been very helpful testimony. We appreciate your coming.

Mr. GILCHRIST. Thank you, Senator.

I hope you are comfortable in our new room. We're delighted to have you here.

This was paid for at lower interest rates. [Laughter.]

Senator SARBANES. It has contributed significantly to improving the efficiency of the county work force. [Laughter.]

We will now hear from Mr. Leon Enfield, who is the president of the Maryland Farm Bureau.

Will you come forward, please.

I acknowledged earlier the presence of Ruth Specter, the president of Montgomery County Council.

I'm pleased to see that Delegate Jenny Forehand is also with us, who represents you so well.

Thank you, Jenny.

Mr. Enfield.

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[1] See exhibit II, p 164.

STATEMENT OF LEON B. ENFIELD, PRESIDENT, MARYLAND FARM BUREAU, KNOXVILLE, MD.

Mr. ENFIELD. Senator, my name is Leon Enfield, president of the Maryland Farm Bureau, the general farm organization of over 12,886 member families in 23 counties in the State.

Maryland Farm Bureau appreciates the opportunity to comment on the effects of current high interest rates on the agriculture community.

I'll read a portion of my prepared statement, and then I have some comments that I would like to make in addition to that.

In general, high interest rates have the effect of reducing net farm income by increasing expenses in the form of high interest payments. Production loans are an unavoidable expense to most farmers, who must borrow against their crop to buy the seed and fertilizer and other farm chemicals necessary to plant it.

Likewise, livestock producers must borrow against their finished herd to buy the young animals that become the finished herd.

Profit margins in agriculture have always been low, and production loans, currently in the 14- to 17-percent range, can easily erase profits that might have been realized.

The general state of our economy is directly tied to the productivity of American agriculture. Were it not for agricultural exports, our balance of payments deficit would further unsettle the stability of the American dollar.

It is important, then, that American agriculture be prosperous in order to be productive; and present high interest rates function counter to that goal. Farmers are reluctant to expand and purchase additional equipment, land, and buildings with 14- to 20-percent money.

Furthermore, even those farmers with reserves, who would not have to borrow, are reluctant to remove their money from high-interest-bearing accounts earning 15- to 18-percent return.

High interst rates discourage capital investment in agriculture, as in any business. Hardest hit are those farmers who have an urgent need to replace large farm machinery or farm structures and are unable to put it off.

New equipment loans, now in excess of 18 percent, cause great financial hardship to those who are caught having to make a large investment in order to stay in business.

I would like to give you some examples of just what some of those costs are.

I talked with Don Rauh, who is the manager of production credit, Farmland Bank & Credit, to get some information, because he probably makes more agricultural loans than anyone else in the area and has a good assessment of the situation as to what is really happening. He gave me several "for instances," as how high interest rates have affected the farmers.

He says right now he is making loans to farmers that have to borrow money to stay in business throughout the rest of this year and pay some of the debts that they presently have. He knows some of these farmers are going to have trouble paying those loans back. It's either a case of he makes the loans, hoping things will straighten out, prices will go up, and they will be better able to make that payment next year or in 18 months, within 2 years, or they'll go out of business within the next few months.

He is also making loans to people he has never seen before, people who have never had to borrow before, coming in and borrowing for production credit in order to stay in business.

We've had a rough season, really, even though it looks beautiful when you drive out through—for instance, our wheat crop this year was hit by mother nature, with a hot spell right at a time when the wheat was blossoming. It didn't mature as it should. Much wheat that would have gone for seed and for flour uses has had to go for feed at a much lower price. Many farmers figured on that money coming in to be able to pay their taxes or pick up some of their fertilizer expense that they've had in the spring. This has either been nonexistent because they kept the wheat there on the farm for feed or they had to sell it at a lot lower price.

So, people who have never borrowed money to pay taxes before are borrowing money this year to pay their taxes.

He sees rough times ahead for the farming community. Our prices are down. Wheat has dropped down to around $3. Corn is said to be going to around $2.50 a bushel, which is low with today's costs.

The price of milk has been held the same; it hasn't increased with the inflation. As many of you are aware, the Congress voted, back in April, not to allow the increase that was scheduled to come to farmers, some 88 cents a hundred on the price of milk. From Montgomery County on west—in western Maryland, we are a heavy dairy area—it has very much affected them because of the inputs that they have put into the business; and it has gone up, and their income has stayed the same.

He sees more bankruptcies, more foreclosures. And it's going to be a lot harder for the farmers to get loans.

In the past, most lending institutions have looked at the farmers, looked at their equity, and they have loaned them money.

Now, instead of looking at the equity—no matter what it is—they're going to look at the ability of that operation to pay back that loan, because they aren't really in the land-holding business. They don't want to come into the business of holding land.

For instance, a $30,000 tractor, which is really not a big tractor by today's standards, on a 5-year payback plan, 1 year ago, at 11½ percent interest, would have cost the farmer $659 per month. Now that interest is 16½ percent just in 1 year—this is through production credit—and $737 a month, or an increase of $77.76 per month over a 5-year period. That's just an example of an equipment loan, operating loan.

For a farm loan—and he just had a farmer come to him in the last week whose figures were fresh—with a $200,000 farm, 1 year ago the interest rate would have been 9¾ percent, for a payment per month of $1,718.40. Now that same interest rate is 13 percent; his monthly payment is $2,212.40—so an increase of $494 per month.

They figured it up on a 30-year paycheck on that farm. And this is the amazing part, the $200,000, which was the original amount the farmer needed under last year's interest. Under the increase in interest, in 30 years, the interest will be—or the total amount paid back by that farmer will be $796,464 to buy a $200,000 farm. He'll pay $796,000—the increase in 1 year in the interest costs alone on the total loan of $177,811. It's amazing.

I asked, "Did that farmer then turn it down and decide not to take the loan?"

And he said, "No, He's going ahead. He may make it; he may not. But he's figuring on inflated dollars continuing on; that's the basis he's going on."

These are just some of the examples.

Another one hits a little closer to home, maybe, to many people. And it's not exactly agriculture, but it's rural, and it's a part of the Federal Land Bank lending program. They loan homeowners now. Several years ago that interest rate was 8½ percent, and now that some interest rate is 13 percent.

And what he's finding there in the homeowner loans that they have made, they are having problems, whether to have one income, two incomes, or just having trouble making payments. Their increases have gone up.

One example he gave me, the monthly payment has gone up approximately $100. And you consider that, along the increased cost of gas, fuel, electricity, and other various inputs, they're having trouble making the payments, and they're going to lose their homes.

It's a rough situation in agriculture, and I'm sure you heard that yesterday on the Shore. Farmers—I think one of the things bothering them the most—a year or so ago we heard inheritance taxes, estate taxes, was the biggest concern. Now though, when you talk to the farmer, it's interest. The interest is killing them.

Senator **Sarbanes**. Let me ask you this question. Are you finding your suppliers have changed the terms on which they make goods and services available to you?

Mr. **Enfield**. Some of them have, and some of them are trying to ride it out.

I talked with a friend of mine whose father-in-law is in the farm equipment business, selling feeds, mostly farm supplies. He has money on the books that he has never—from people who he'd never had money on the books before. And he has more money on the books than before.

Back to locally, we still find that some of the large manufacturing companies are using every incentive plan they can to try to stimulate the farmers to buy equipment. They're giving interest-free loans for a period of 6 to 8 months.

I just recently purchased a hay baler in July. The deal I got on that—and they brought it down the bottom dollar, so there was two dealers competing against one another in order to make the sale. And it happened that the main factory representative was there, and he said, "Sell that piece of equipment if you possibly can."

They dropped over $1,000 in their initial terms, and they gave me free financing until January 1, at which time I have the option of paying the complete off or letting the loan go on through and pay it off over a 2-year period at 19½ percent interest. I'm going to pay it off before January 1.

But in order to have that incentive there, they gave us the 6-month free interest.

I just noticed some of your manufacturing companies are doing some of the same thing, interest running now into next May, interest free on various types of equipment, using every incentive they can to get the farmer to try to go on.

Of course, what is happening in some cases, farmers are taking that, and they are getting themselves overextended. And then they are in trouble when the payments come due later on.

Also, the equipment companies have slowed down their sales. New sales have slowed down. They have more equipment sitting on their lots, more new equipment. They can't move it. They are hurting. Their employees are going to be hurting, just having a reflex statement all the way back through—it reflects all the way back through

Senator SARBANES. We had testimony yesterday that fertilizer dealers, at least in some of the Shore areas, had previously carried the farmer over the season, but now come in with the bill on monthly terms. In other words, if it's not paid at the end of the month, they put a charge on it, something apparently they had not done heretofore. They, in effect, have recognized, as someone said—I think it was Roger Richardson—"The only time the farmer has money is in the fall. The rest of the time he's out there, extended."

Is that happening across the State, to your knowledge?

Mr. ENFIELD. I'm sure it is, but I'm not that knowledgeable as to what's happening in the fertilizer industry right now in our county. I bought it the first of the year and only had to buy a little bit this year.

I do know another thing that's happening. Interest on these accounts—many dealers, it has now gone to 24 percent or 2 percent a month instead of 1 percent or 1½ percent. It has moved up now to 24 percent a year.

Senator SARBANES. You said earlier, Mr. Enfield, and I think it's a very important point that needs to be underscored, that even those farmers who have money to invest and therefore do not have to borrow to make their farm enterprise more productive and more efficient are unwilling to shift their money into that area, as opposed to simply putting it into money market funds and collecting high interest rates.

How much of that is going on, would you say?

Mr. ENFIELD. I think it's less than what we would hope it be, because there's just not that much free money floating around that the farmer has——

Senator SARBANES. Are you saying farmers are thinking about liquidating capital investment because they can put it out and get the high return just by playing it in the market? Do they say "Why don't we just get out of the farming business altogether?"

Mr. ENFIELD. I hear that comment all the time, but I haven't seen too much of it happening yet; because those fellows that could really do that, they're the ones that are probably going to stick it out anyway, unless they're about retirement age.

If they are, I'd say, 55 to 60, they're probably pretty serious in what you're saying. But a young man that says that, he's probably just talking; he's going to keep on farming anyway because he's just that kind of a guy. But the ones—some of them that you don't hear talking about it, they're being quiet because they know they do have problems, and they really don't want to talk about it. They're the ones that are going to be liquidated because they just can't make it.

Senator SARBANES. I take it it's almost impossible for younger people to get into farming under these circumstances; is that correct?

Mr. ENFIELD. It has been hard for some time. It's not impossible. There are a few starting out now. But it's getting much harder all the time. And with the interest rates in the past year, I personally don't see how they can get it going unless they really have an outstanding family help of some kind. And even with that, you've got to pay back any debts that you establish in a family operation, even if you're taking over a family operation.

One thing that has helped in the new economic package—I think, along those lines, as I understand it, the IRS now requires a 9-percent interest rate. And under the new package, that has dropped to 7.

It does seem to me that it's kind of ridiculous when a father wants to pass along part of the farming operation and can't even set his own interest rate.

Senator SARBANES. We thank you very much.

Mr. ENFIELD. Thank you very much.

[The prepared statement of Mr. Enfield follows:]

PREPARED STATEMENT OF LEON B. ENFIELD

Mr. Chairman, members of the Subcommittee, my name is Leon Enfield, President of the Maryland Farm Bureau, a general farm organization with 12,886 member families in 23 counties. Maryland Farm Bureau appreciates this opportunity to comment on the effects of current high interest rates on the agricultural community.

In general, high interest rates have the effect of reducing net farm income by increasing expenses in the form of high interest payments. Production loans are an unavoidable expense to most farmers who must borrow against their crop to buy the seed, fertilizer and other farm chemicals necessary to plant it. Likewise, livestock producers must borrow against their finished herd to buy the young animals that become the finished herd. Profit margins in agriculture have always been low and production loans currently in the 14 to 17 percent range can easily erase profits that might have been realized.

The general state of our economy is directly tied to the productivity of American agriculture. Were it not for agricultural exports, our balance of payments deficit would further unsettle the stability of the American dollar. It is important then that American agriculture be prosperous in order to be productive, and present high interest rates function counter to that goal. Farmers are reluctant to expand and purchase additional equipment, land or buildings with 14 to 20 percent money. Furthermore, even those farmers with reserves who would not have to borrow are reluctant to remove their money from high interest bearing accounts earning a 15 to 18 percent return.

High interest rates discourage capital investment in agriculture as in any other business. Hardest hit are those farmers who have an urgent need to replace large farm machinery or farm structures and are unable to put it off. New equipment loans, now in excess of 18 percent, cause great financial hardship to those who are caught having to make a large investment in order to stay in business.

It should be said here that Maryland Farm Bureau and the American Farm Bureau Federation look to the President's Economic Recovery Program for relief from the "ham-stringing" effects of high interest rates as well as skyrocketing production costs and government over-regulation. In 1979, farmers spent $2.1 billion on additional facilities and equipment net of depreciation replacement. With the administration's tax cuts, the averag 1.15 billion farmer tax savings per year could add 54 percent more new investment in agriculture per year compared to 1979. These savings do not include the potential tax savings to farmers from the changes in depreciation and investment rules. With the implementation of the various facits of the Economic Recovery Plan, we look for interest rates to begin declining, but in any event, farmers will better be able to afford them.

In summary, Farm Bureau believes that action necessary to restore the farmer's confidence in our economy is being taken by the present administration. We also observe that the present Congress is acting more responsibly to the needs of business which, in the final analysis, creates the productive jogs and economic growth that gives Americans the highest standard of living in the world.

Again, Maryland Farm Bureau appreciates this opportunity to appear before this subcommittee to express our views on this important matter affecting the agricultural community.

Senator **Sarbanes**. I think it's very important to hear from the farm community, which I think is much too much taken for granted. Our farmers are so efficient that we're able to meet our own food needs and supply a good part of the world.

Other countries are not able to do that. Many of them can't even meet their own food needs. And where they do, they have a much larger percentage of the population involved in doing so. We get it down to a very small percent. Where is it, about 5 percent?

Mr. **Enfield**. Around 3 now.

Senator **Sarbanes**. Down to 3.

Most people are just not involved in farming. A lot of people, therefore, don't fully appreciate the contribution which the farm sector makes to the economy.

In a sense, your efficiency, which means you're a smaller proportion of the total population, makes it easier for the rest of the country to overlook the contribution you are making. I just want it underscored—because we have a very strong farm community in this State.

Mr. **Enfield**. This is the thing that's worrying me now, what's going to happen if we continue on at the present levels for another 3 to 5 years? How many of our farmers are we going to lose?

They keep saying the world is going to be hungry in the next 20 years, 25 years, and on beyond. Yet, if we let our agricultural economy go down and our farmers go to the wayside and try to make a living somewhere else, I don't say our farms will lie idle, but our people will disappear. We can't turn that switch back on overnight when we need it. We're in low prices right now and everything else and very discouraged. Yet, down the road somewhere they keep saying everything is going to be great, agriculture is going to be the greatest thing there ever was.

But we've got to keep him going in the meantime. Just as you said, a lot of people don't realize—I was in upper Montgomery County this summer. A comment was made at the event I was at. My family and I needed to get home. We had cows to milk. Some lady standing nearby said, "What's his hurry? 7-11 is open until 11 p.m." [Laughter.]

Senator **Sarbanes**. Thank you very much.

Mr. **Enfield**. Thank you very much, Senator.

Senator **Sarbanes**. Ms. Fraser Swartzwelder, who is the assistant to the chief executive officer of the Montgomery County Teachers Federal Credit Union, and Mr. John Whiteside, who is the State director of the Independent Bankers of Maryland and president of the Commercial & Farmers Bank in Ellicott City. And I have a statement from Robert Smith, president of Maryland Federal Savings & Loan, which will be included in full in the record at the close of the financial institution panel.

Ms. Swartzwelder, please.

STATEMENT OF E. FRASER SWARTZWELDER, ASSISTANT TO THE CHIEF EXECUTIVE OFFICER, MONTGOMERY COUNTY TEACHERS FEDERAL CREDIT UNION, ROCKVILLE, MD.

Ms. **Swartzwelder**. Thank you, I wish to thank you for the opportunity—for the invitation and the opportunity to speak with you and to listen to my colleagues and neighbors on what they have to say on the subject that is vital to my credit union as a financial institution, as a financial focal point for the thousands of Montgomery County education and associated employees.

My credit union, like many of the institutions that you're going to be hearing from this week has been going through extraordinarily difficult times. During 1980 our over 20,000 members endured a year of loan service cut back so severely that other than a savings-secured loan, they were only allowed to borrow a total of $1,000 during that entire 12 months, and that was only for emergency health, welfare, and safety reasons for themselves or for their families.

Our cash flow is a critical problem. On December 31, 1978, our equity contained $33 million in regular shared savings accounts; 31 months later on July 31, 1981, our balance sheet showed only $24 million in the same accounts.

Our contingency reserve, which is our piggy bank, has dropped from $835,000 to $238,000. Approximately $1.5 million is now member-invested in high interest, that is, high cost, time instruments.

The service which we are able to provide to our members is reflected in our loan portfolio. During the same 31-month period since the beginning of 1979, it dropped from 12,000 loans, totaling $24.583 million to 7,000 loans totaling $13.744 million. During the 12 months of 1980 we made only 1,854 loans and our usual volume is 10,000 to 11,000 loans, because we lacked the sufficient cash flow to do anything more.

Montgomery County Teachers Federal Credit Union is not unique in the Federal credit union industry, and I hear some people call us fortunate. Credit unions today are suffering a new outflow of funds. The money market funds are still taking their toll, and a look at the ads in the paper for banks and savings and loans gearing up for the October 1 instruction of the all-savers certificates can explain the rest. The competition for these high-cost funds in the race for survival is very fierce.

I am terribly aware that the mortgage-based savings and loan industry is red ink. The Federal Home Loan Mortgage Corporation tells us they are looking for ways to help the mortgage lenders. The hope through legislation to make some basic charter changes and extends their SWAS, which are exchanging mortgage loans for participation certificates, by removal of the 20-percent limitation on the total volume of mortgages that they can hold that are more than 1 year old when they are sold to the corporation.

I've heard proposals to allow savings and loans to amortize a loss resulting either directly or indirectly from the sale of mortgages over the life of the mortgage. This would allow savings and loans to sell their participation certificates below par, increasing their cash flow without going under by having to take a big loss, a big immediate loss all one time.

Many financial institutions supported the housing industry, and therefore provided housing to millions of families through purchase of Government-backed mortgates. For examples, GNNA's, FNMA's, and so on, at rates that are, in today's market, unsalable. These are the 7 and 8 percent. These certificates do allow the holder access to money in the form of reverse repos or collateralized loans at rates a couple of percentage points below prime. But please note it would take quite a number of years at higher loan interest rates than we're charging for our loan portfolio to turn over sufficiently to even begin yielding this kind of interest. We are in a bind.

I would like you to allow me to submit a germ of an idea, a program whereby a hold of this type of certificate could sell the certificate or a portion of them to the guarantor, that is to the Federal Government, in exchange for the present face value. This would liquidate at least a portion of the financial institutions or individual assets and let the management start serving their members properly again. As the holder of record, the Federal Government would be receiving the payments of principal and interest that would be ordinarily payable.

The people in this room can immediately come up with questions and problems, and any number of effects this proposal could cause. I don't feel that they are for me to answer; they are for all concerned to ponder and address. I merely wish to propose the idea and hope that you, Senator Sarbanes, the financial industry, the Federal Government, and the members and customers of our troubled financial institutions will give this consideration.

Senator **Sarbanes**. Thank you very much for a very thoughtful statement.

Mr. Whiteside, why don't we hear from you, and then we will go into questions.

STATEMENT OF JOHN S. WHITESIDE, STATE DIRECTOR, INDEPENDENT BANKERS OF MARYLAND AND PRESIDENT, COMMERCIAL & FARMERS BANK, ELLICOTT CITY, MD.

Mr. **Whiteside**. Senator Sarbanes, I'd like to thank the Subcommittee on Investment, Jobs, and Prices, of the Joint Economic Committee, for the opportunity to present my views on the high interest rate problems we're facing. I have been asked to address my comments to the impact of high interest rates upon Howard and Montgomery Counties. I feel these counties are in the same position as many others in the Nation today. All share in common the problems of failing auto dealerships, struggling homebuilders, and endangered financial institutions.

I think it is important to try to identify some causes and in so doing to consider what it will take to effect a cure. It is common knowledge that many financial institutions are on the brink of insolvency, since they carry large investments in the form of low-yielding mortgages created back in the 1960's and 1970's; however, while our average customers reaps the rewards of high interest rates on his investments, an increasing appreciation on the home he purchased in the 1960's and 1970's, he views with horror the resultant rate he has to pay on his new car purchase, for a home improvement loan. He continues to drive his aging car and puts off repairing. His decision to invest his dollars curtails his spending, since he won't borrow at the high interest rates.

Local merchants soon feel the pressure of reduced profits and must postpone any planning expansion. Businesses reduce their working forces. In many cases, marginal businesses are forced out of existence. Community growth comes to a standstill and unemployment increases. Lower income families, unable to pay the increased interest rates and faced with reduced Government subsidies are the hardest hit.

Local farmers also cut up on the high interest borrowing are forced to pay higher prices for feed, fertilizer, seed, and so forth, as well as gasoline to run their tractors and other farm machinery without a proportionate increase in the price of their products.

In recent years at the small community bank, we have witnessed, along with our big brothers, changing attitude on the part of our depositors. The average customer, in the 1960's, content to accept the 4 and 5 percent on his savings dollars, has become increasingly sophisticated, until now in the 1980's, he takes his dollars where he is able to get his maximum value. Loyalty to the institution which made him a 6 or 7 percent mortgage loan back in the 1960's is forgotten. He wants to know what his bank is going to do for him today.

And who can blame him, given the rate of inflation. His bank meanwhile, is laboring under the restrictions of Government regulation and artificial ceilings and is only partially able to give this customer what he is demanding.

Competition springs up everywhere from insurance companies, investment firms, and large retail establishments willing to pay him higher yields for his money without the burden of Federal regulation. The U.S. Treasury at the same time is having to pay these savers, these suppliers of money, yields as high as 8½ percent at their weekly auction of Treasury bills.

The problem, I believe, becomes clarified if one simply looks at money as if it were any other commodity. Financial institutions merely buy and sell money with the expectation of making a profit. Obviously, they cannot sell their product for less than they paid for it.

The all-savers program which begins on October 1 is thought to be one remedy to the savings and loan industry's dilemma. They're getting money perhaps at 10-percent cost. Seventy-five percent of this new money must be put into mortgages or agricultural loans; however, it would seem inconceivable to me that any institution should begin creating mortgages that the public yearns for at a fixed rate for 30 years, using money that Congress has mandated will only be around for approximately 2 years.

If the U.S. Government is going to continue to borrow increasing amounts from the public and that same public is going to insist on higher yields for use of their money, then we should be prepared to swallow the bitter pill of high interest rates and realize that there is no such thing as a free lunch.

Senator **Sarbanes**. Thank you both very much.

I'm interested in this question of your depositors. First with respect to the credit union, where there often exists a great deal of loyalty and a great deal of convenience. Are you finding that that is enabling you, along with the better rate that you're paying, to hold your people?

Ms. SWARTZWELDER. The number of members is staying the same, is not decreasing dramatically. The amount of money that they hold in the credit union, the average share averages less.

Senator SARBANES. So they stay with you in the sense—not exactly part of your family, but their commitments.

Mr. Whiteside, you say you are finding that with your people?

Mr. WHITESIDE. Yes, Senator, I would answer much the same way. I think we're keeping our customers, but our customers are choosing to place their dollars in other places. Hardly a day goes by in my bank that a customer does not come in asking us to sign a signature guarantee form to enable him to open his money market funds. So we know that we are losing dollars to the market funds. We know that we are transferring dollars out of the 5¼ percent yielding account into the money market certificate which we have sold since its inception.

So I think we're holding on to our customers. I don't want to give the impression that loyalty is dead in a community bank, because I think that's one of the strengths of community banking in this country.

But our customer, a very sophisticated one in my market, is always seeking the higher yield on his moneys. And I can say in all candor that I don't blame them.

Senator SARBANES. May I ask you this question? Where were you and where are you now putting your money when you—when the bank puts it out?

Mr. WHITESIDE. We are making loans to the businessman.

Senator SARBANES. In your local community?

Mr. WHITESIDE. In our local community. We're making consumer loans in our community.

Senator SARBANES. What is your perception of where the money is going when your customers, in effect, diminish their commitment to you and send it into the fund? What is your perception of where that money is going?

Mr. WHITESIDE. I don't have all the answers, Senator, where that money is going. I do know that it doesn't find its way back into the community. And I see that as the worse part of the situation from the community banker's standpoint. The community banker takes the funds in from his community and lends them in his community to foster growth and prosperity.

When those same dollars leave the community to seek the higher yields in the money market funds and other instruments, it goes anywhere but back in the community.

Senator SARBANES. We held a hearing in the Banking Committee which underscored the fact that this money is really being drawn in from all over the country to merely just a few financial centers. In some instances, as much as 30 to 40 percent of it is then put, for instance, in the Eurodollar market. It's going wherever it can get the most immediate short-term return. I think at the cost of the kind of community investment that banks such as yours, S. & L.'s and other similar institutions have traditionally done. That's probably even more true in the more rural areas of the State than might be in Ellicott City, I think.

What do you see as the prospects of the continued viability of the credit unions and the small community banks?

Ms. **Swartzwelder**. It's almost impossible to give, and it's because of a lot of things that are going on in the marketplace. As for instance, credit unions seem to be going in two directions. One is that some credit unions are becoming full-service organizations. Others are staying very individual-minded. They are staying the small clubs that they were formed to be one person saving that another person can make a loan.

I feel that there is still a place for both of these organizations. Both of these types of credit unions. There are many credit unions that are in trouble that are having—you know, that sounds more deep than it is. There are many that are having to struggle just as we are. For instance, we are an educational union, and it's summertime, and Montgomery County has the predominance of its employees on a 10-month schedule. Our money is going out very fast right now. It's been going out steadily. It's a matter of what we can do, what the marketplace will allow us to do.

Senator **Sarbanes**. Mr. Whiteside.

Mr. **Whiteside**. Senator, as a community banker, I expect to continue to be in business. I expect to remain in business by continuing to do what I think we do well, serving our local communities. I know that the job will not become an easier one. It will take a smarter banker. It will take more asset liability management, but I have not met anyone from Citicorp yet who could come into my community and take business away from me.

Senator **Sarbanes**. I think that's a good note on which to thank this panel for its very helpful testimony. Appreciate it very much.

Mr. **Whiteside**. Thank you, Senator.

Senator **Sarbanes**. As I said earlier, the prepared statement of Robert Smith, president of Maryland Savings & Loan Association, who could not be here today, will be included in full in the record, to complete the financial institution panel of our hearing.

I note in it he does comment:

> The price of high interest rates, not the price of management. There are many well-managed enterprises which survived the years of the depression, but very well may not make it through the next year if interest rates continue to escalate.

[The prepared statement of Mr. Smith follows:]

PREPARED STATEMENT OF ROBERT J. SMITH, PRESIDENT, MARYLAND FEDERAL SAVINGS & LOAN ASSOCIATION

I don't believe it's necessary to take a great deal of time to expand upon the effect of runaway interest rates on the Thrift Industry. It is an extremely difficult chore to adjust on almost a daily basis to the volatility of these high rates of interest. The cost of doing business has escalated because of these high rates where the return on assets has been held in check by a portfolio of fixed long term loans. It is virtually impossible for young adults to find financing at realistic interest rates to buy homes. I realize the investment opportunities of the Thrift Industry has greatly been expanded to include automobile loans, consumer loans, etc., but there are only limited funds that can be used; funds are necessary to meet withdrawals from savings accounts. The competition for funds is intense, particularly outside the financial community.

I don't feel that the impact on the Maryland communities is substantially different than the impact on any other part of the United States. It dosen't appear very realistic to expect interest rates to really come down substantially. It certainly does appear that these unprecedented rates are going to be with us for some time to come. If we are going to live with these rates, stability may be the answer. I think we can tolerate a rate of interest, even a high rate of interest, if it is at least consistent. The volatility of rates in the last year or so has eroded the confidence of the American people. They are confused, edgy and uncertain, even those receiving the high rate of return, not just those paying it. The first consideration for stabilizing interest rates at this time is total cooperation from the Federal Government for its funding requirements. The Federal Reserve has controlled the supply of money and the Federal Government must control its borrowings.

Private enterprise, both large and small, are being tested severely. Some will survive, some will not. Many of those which will not survive will be unable to afford the price that is required to be paid. The price of high interest rates, not the price of mismanagement. There are many well managed enterprises which survived the years of the Depression but very well may not make it through the next year if interest rates continue to escalate.

I believe that the scourge of the high interest rates has replaced inflation as the No. One concern in our Country. Rates must be brought under control. They must be reduced and stabilized.

Senator **Sarbanes**. We will continue now with our panel of auto dealers. Mr. Shockley, will you begin please.

STATEMENT OF ALFRED P. SHOCKLEY, PRESIDENT, SHOCKLEY VOLKSWAGEN, INC., FREDERICK, MD., AND MARYLAND DIRECTOR, NATIONAL AUTOMOBILE DEALERS ASSOCIATION, NADA

Mr. **Shockley**. Senator Sarbanes and members of the committee, I would like to make a short statement as the director from Maryland to the National Automobile Dealers Association (NADA) and then relate the impact of high interest rates on my business and that of the other dealers in western Maryland.

During the first half of 1981, 325 franchised new car dealers closed their doors. The single greatest cause of the dealer failure is the burden of floor-plan interest. The estimated average annual floor-plan interest expense per dealer was $13,046 in 1970. During 1980 floor-plan interest expense rose on average to $78,947 per dealer; more than six times the 1970 figure.

With the weighted average prime rate during 1981 running between 3 and 4 percent higher than 1980, the floor-plan interest expense burden during 1981 has been even greater.

Inventory levels on August 1, 1982, set an all-time record for that date of 2.1 million cars in dealer inventories. At the current floor-plan interest rate of 21 percent, financing this level of inventories for the 80 days supply it represents, costs the dealer body $784 million.

Dealer employment between 1979 and 1980 fell from 813,400 to 738,000 employees. This figure does not include the unemployment which resulted from the closing of 1,650 dealerships nationally during 1980. It is estimated these dealer closings represents a direct loss of 44,550 jobs.

The high-interest rates also depress consumer demand for new vehicles. Sales of new vehicles during 1980 were the lowest they have been since 1961. With interest rates even higher in 1981 than they were in 1980, the sales of new vehicles are even lower this year, down 2.5 percent year to date.

The 34-percent increase in General Motors' sales during the first 10 days of August in response to GM's 13.8 percent finance rate promotion, is indicative of the consumer's sensitivity to finance rates.

Now, I would like to talk a little bit about my business, and to relaste a few of my own experiences on the impact that the high-interest rates have had on my business.

I will make some comparisons from July of 1980 through January-July of 1980 and January through July 1981.

My inventory this year is up 19 percent over last year. But my interest rates are 112 percent up over the same period of time.

The interest per car for the same period last year was an average of $85 per car. This year it is an average of $214 per car.

And on down, 9 percent on employees, as you see in my table.

	July 1980	July 1981	Percent difference
New car inventory	421,785	500,876	+19
Floor-plan interest	35,638	75,478	+112
Interest per car	$85	$214	+152
Number of employees	34	31	—

We had projected an expansion of our facilities for late 1981 and 1982 that over a 12-month period would have resulted in additional 10 new jobs. I have postponed any expansion plans because the additional projected income would not be enough to offset the mortgage rates.

Our dealership has always prided itself for its high quality service. We have been able to achieve these high standards because we have trained our own technicians. It takes anywhere from 18 months to 3 years to train a technician before they become fully producting.

For the first time since I have been in business we do not have a technician apprenticeship program.

Our dealers in western Maryland are impacted in two ways by the abnormally high interest rates. First, their floor-plan costs are so high that their working capital is continually being eroded. Their inventories are excessively high because consumers cannot afford to finance new and used cars.

Fortunately, many of them are still profitable. And they are staying profitable only because of good, prudent business practice. But one wonders how long.

I thank you for the opportunity.

Senator SARBANES. Thank you, Mr. Shockley.

Mr. Gordon, please.

STATEMENT OF HERB GORDON, HERB GORDON/GORDON OLDSMOBILE, INC., SILVER SPRING, MD.

Mr. GORDON. Thank you, Senator.

My name is Herb Gordon, president of Herb Gordon Oldsmobile.

I, too, am a new-car dealer. I have two operations in the Montgomery Auto Sales Park—one we sell Oldsmobile and the new Delorean and the other we sell Datsun and Mercedes Benz.

We employ approximately 200 people and do in excess of $30 million business annually.

During my 26 years in the automobile business there was a long period of time when rent was our one single biggest expense. About 8 or 9 years ago, this was supplanted by advertising as the one big and largest expense. And I was shocked to learn that in the last 8 or 9 months our interest expense on inventory financing has hands-down become the one largest expense in our business.

To give you an illustration, in the month of July—and this is in spite of the fact that in our operation we own a pretty good portion of our own inventory—but on top of that our inventory financing cost was in excess of $55,000, or if you want to annualize it, close to three quarters of a million dollars.

If we add to this the passthrough interest costs and the implied cost of the inventory that we own, the amount of money involved would be staggering.

One can say that interest expense is nothing new to the economy, and certainly nothing new to the auto industry, and that would certainly be correct. The difference is that less than 2 years ago we were accommodating interest expense in the range of 8 or 9 percent, which was considered to be excessive. And today we are being asked to accommodate interest rates in excess of 20 percent in terms of inventory financing, and upward of 15 to 20 percent as far as consumer financing is concerned.

Al made a comment that the General Motors' 13.8 percent finance package that was going on through the month of August—and being a General Motors dealer, the results were startling insofar as the rate was so far into the market. But this was a temporary situation, and even General Motors, as large as they are, cannot support a deficit in their interest rate expense.

As far as interest rate in terms of expenses are concerned, I always thought of expenses as being productive. To me expenses such as payroll, purchasing of inventories and so forth, keep people employed. It regenerates through the economy.

I fail to see where increased interest rates are productive at all. In fact, I find them counterproductive insofar as they create a situation that forces business people to curtail, as opposed to moving ahead.

In Montgomery County, which is supposed to be recession proof and immune from major business adversities, we have had dealership failures; and what we see in this regard today may be just the tip of the iceberg; as there are many, many dealers who are hanging on hoping for relief. And, if this relief is not forthcoming soon, they, too, will become a statistic.

The interesting thing is when you look at industry and you look at business failures, in many cases the failures may exceed what is published because you have situations where the manufacturers may come in and replace a failing dealer with a sponsored dealer on their part so that you still may see XYZ Motors on the corner of G and H, and yet it may have changed hands.

So that the failures even in relation to Montgomery County, may be greater than they show on the surface.

Consumers also suffer from high interest rates, not only through high financing costs, but as a result of pass throughs, which also occur in other parts of the business. When absolute expenses go up, whether they are created by high interest rates or any other factor, any businessman is going to recapture these expenses. And in many cases the recapture of increased expenses occur in the used-car operation, occur in the parts and service operation or other aspects of the dealership functions.

Lastly, there is the loss resulting from decisions not to do things. These decisions not to do things would result in more employment in the State. As an example, we have just postponed plans to build another facility in the Auto Park on a 4-acre site. We were planning on taking on another line of cars.

Our reason for postponing this was the projected cost of the land and building would be in excess of $2 million. At today's financing costs, we are looking at a mortgage constant approaching $400,000. And we thought it would be imprudent to go ahead with this project at this time.

Now there are 70 jobs that might have been created, that will either not be created at all or will be postponed for a time.

We in the industry understand the reason for keeping money tight and expensive. We, too, are hurt by excessive inflation. However, we feel the high interest rates are, in themselves, inflationary as they add a substantial amount to the real cost of goods and services. We are not sure that these monetary policies are working, and feel that the interest rate cure may be killing the patient.

I thank you.

Senator SARBANES. Gentlemen, thank you for a very poignant and effective testimony.

Mr. GORDON. I think your point about policy working in a counterproductive fashion is very well taken. The jump in the consumer price index last month annualized at 15 percent. Of course, it is tricky to annualize off a month's figures. But in any event, when you go behind it, much of that is due to the housing sector. And that is attributable to the high interest rate.

The cost of money is being passed on in other aspects of prices and, therefore, reflected in the consumer price index.

So, policies put in to "control employment" could in fact, feed inflation.

And I think your point about employment—as I understood it, you actually laid some people off—

Mr. SHOCKLEY. Just through attrition. We haven't really fired them. We have been a growing business continuously.

Senator SARBANES. And Mr. Gordon has done the same thing, in terms of not moving forward, where he might otherwise have done so, and therefore providing jobs which, of course, make people wage earners and taxpayers and bring money into the Treasury, instead of leaving them idle to go on unemployment or some other support payment and drawing money out of the Treasury.

So, even if you address the question of the Federal deficit, it seems to me the higher interest rates, by restricting economic activity are contributing to the deficit let alone the contribution by increasing the cost of sharing the existing Federal debt. Let me ask you this question: Is the 13.8 percent money that GM is now moving, is that a level that will open up the door to sales?

And if so, is it only in comparison—is there some kind of level where, if you could get interest rates down to that range, you at least could resume some degree of normal activity as you see things, something above the absolute survival level, yet short of "opening up the floodgates" and sparking a kind of intense economic activity which might fuel inflation?

I understand that argument, that you're just heating everything up, and have difficulty understanding it in the context in which things have almost closed down altogether.

Mr. **Gordon**. I think there is—what that percentage is will change with the times.

As a case in point, it wasn't so long ago that we were all appalled at the thought of paying 11 percent for mortgage money. Now, if we get a mortgage at all, if that rate is under 17 percent, we feel it's some sort of a bargain.

I think the amount will change with the consumer's perception as to what a fair or low interest rate is.

In this particular situation, 13.8 percent did create a tremendous amount of activity and did create a tremendous number of sales—again, for two reasons:

There has been pent-up demand insofar as the industry has been depressed for the last 2 years.

And second, the reality that people are not seeing anything in terms—in relation to a severe downturn in interest rate.

Also, 13.8 became a very attractive number to them: it did bring people out.

I think, today, that—in my view, 13.8 is still high enough where I don't see that as being a precipitator of heating up the economy. I don't see people borrowing vast sums of money at 14 percent.

Yes; I think there is a number. I think it changes. I think today 13.8 was the number.

Senator **Sarbanes**. I ought to observe that the real interest rate right now is really at an incredibly high figure. In other words, ordinarily it has run 2, 3, or 4 points over the inflation rate. But now—and you can argue about what inflation rate you are dealing with, but clearly, even if you take a 10- to 12- percent figure and add that on to it, the existing interest rates are far in excess of what has been traditionally seen as an acceptable real interest rate figure.

So that cap is very much there. And I think there is another argument, strong argument, for perceiving the levels now as being far too excessive and impacting in a highly negative way on the economy.

Have the manufacturers sought to shift the burden of this back onto the dealers? Or are they in the boat with you, so to speak, in trying to address the problem?

Mr. **Shockley**. I can speak as a Volkswagen dealer. When that car is unloaded off the truck and hits the ground, I start paying interest rates on those cars. And we have no program.

What General Motors is doing, I'm not sure.

Mr. **Gordon**. It varies. The import makes that we handle—with the exception of one brief period where Mercedes-Benz had a participating program to mitigate some of the costs of floor planning, the importers generally threw that burden on the dealer.

General Motors has had some participating programs to help reduce the real cost of inventory financing. Again, in the last analysis, everybody pays for it, because it creates, as I said before, a passthrough.

Senator **Sarbanes**. Have the sources of the financing for the car purchases—have your purchasers shifted over the last few years in terms of where they go to get their financing? It is almost entirely to GMAC?

Mr. **Gordon**. A very interesting thing has occurred there. In our case, our primary source of financing happens to be a bank. We do some business with GMAC, and this 13.8 percent caused some problems with some of the banks that were active in the financing because they had to reduce their rate to become competitive with General Motors. And this happened, in our particular situation, with our bank.

Yes; the rates at which banks make money available, making money available today to dealers, banks doing indirect financing are generally more favorable than what they make available to an individual walking in.

Many banks have gotten out of consumer financing for lack of money. So that the shift has been that the consumer has gone away from getting their own financing and more to dealer-sources' financing.

Vis-a-vis the 13.8 percent that GMAC had, obviously there wasn't a bank in the country that would have a walk-in rate at that level or under.

Mr. **Shockley**. In western Maryland, traditionally most of your small banks up there are still financing cars. The average new car is being financed at about 16 or 16½ percent.

Senator **Sarbanes**. That's interesting, because we had testimony from dealers elsewhere in the State that carried it a step beyond, Mr. Gordon—in other words, had the consumer moving to dealer financing. And then, in their instances, the dealer financing had moved to where it was captive—essentially to GMAC or to the company's plan and no outside sources.

Mr. **Gordon**. I think that's generally true.

In our particular situation, in Montgomery County, we happen to have one bank that is very active in installment lending, indirect dealer lending. And this is a $700–$800 million bank with installment lending exceeding $200 million, and they're active. It's unique to the country; it's unique to the State.

But I think, as a general rule, what you heard in other counties is true. More and more dealers are going to the manufacturers' captive financing sources, because they do have funds available.

We are, again, in a unique situation with this one particular bank.

Senator **Sarbanes**. Gentlemen, thank you very much for some very helpful testimony.

We'll now hear from the panel of realtors, Dale Ross, Robert L. Gruen Co., in Rockville, and Peggy Lekstrum from Quest Realty in Frederick.

Ms. Lekstrum, if you will begin the panel.

STATEMENT OF PEGGY LEKSTRUM, PRESIDENT, QUEST REALTY, INC., FREDERICK, MD., AND MEMBER, FREDERICK COUNTY BOARD OF REALTORS

Ms. LEKSTRUM. Thank you, Senator.

You have a copy of my prepared statement, and I will be interjecting into that as I give my testimony.

Most of us all have that American dream of owning our own home. This used to be a reality for most families.

What has occurred to make this dream unobtainable in the average family today? The change is the cost of home mortgages.

In 1978, the average interest rate was 9 percent. Thus, a mortgage of $55,000, financed for a period of 30 years, had a principal and interest payment of $442.54 per month. To qualify for this mortgage, the combined income of the wage earners had to be $1,770 per month, or $21,241 per year.

Today, the same mortgage, of $55,000, costs the family $759.29, in principal and interest, per month, based on the current conventional average of 17¼-percent interest. To qualify for that mortgage, the combined income of the wage earners must be $3,181, or $38,173 per year.

This is an average increase in interest rate of 19 percent per year.

What wage earner has a 19-percent per year pay increase? The average disposable income of a Frederick County resident at year-end, December 1979, was $18,334. As of today, we do not have the 1980 census figures on that income.

It is not the purchase price of the home that has caused this increase. The average price of a home in Frederick County in 1978 was $53,969. As of June 30 of this year, the average sales price is $71,369, an increase of only 12.9 percent per year, versus the 19-percent increase in the interest rate.

I have a letter, submitted by one of our mortgage bankers in Frederick, that will give a little more impact as to what is really occurring, quoting from the letter:

> I am finding business has fallen off over 50 percent in the past 2 months, compared to a year ago. According to HUD's Area Office, last week's—not just for the whole year, just last week's applications numbered 44, compared to last year's figures of 65 per day.
>
> * * * * * * *
>
> Many of the things that are helping the financing industry when it comes to mortgages can be said to be innovative, creative, and necessary to aid people in buying homes. The tax advantage of homeownership, the ability to qualify, are diminishing to a point where people are not buying.
>
> In this county, we are a growth area, but we cannot grow, people cannot buy houses, sellers cannot sell, and banks that do not have funds to lend—and those of us that do are requiring yields of 16½ to 18 percent. Everybody is waiting, except for those who cannot afford to wait or sellers that must move. Therefore, they take risks in holding mortgages themselves.
>
> Where they adjust prices to cover financing costs, which is inflationary, builders are going out of business and sellers sell underpriced to relocation services.
>
> In the past few days, I have found that one of the area's relocation specialists now hold almost 20 houses vacant. This is just in Frederick County.
>
> Another recently closed a transaction where they will lose a substantial amount due to market conditions. The question then raised is: How long will they continue to take these losses to sell houses and therefore let our people be transferred within their corporations?

These rates are not just affecting homebuyers. What about the sellers? They transfer, they must move. Unless they are fortunate enough to have a mortgage that is assumable or one that we can be creative with, they will have a minor role in the marketplace.

In some families, the husband in leaving the wife and children behind to sell their home, leaving him by himself in a new area in a hotel room. Some are bearing the load of double house payment, or house payment and rent, or house payment—new house payment and payment new bridge loan to cover their equity downpayment on the new property until their present home is sold. Some are even letting their home go to foreclosure, rather than bear any of those burdens.

I have with me a letter from a Frederick County resident living in Monrovia who is now caught in a very unusual hardship situation.

It's address to you, Senator Sarbanes.

> For that past 4 months, we have been trying to sell our home in Monrovia, Maryland. We have had numerous possible buyers look at our home. But because of the high interest rates now, we have been unable to find a qualified buyer.
>
> We recently signed a contract with a qualified buyer, and two days later the bank removed the RAP, which now makes it impossible for the people to buy our house. The very day the bank removed the RAP, unbeknown to us, we had borrowed $49,000 from another bank in order to make a settlement on our new home in the form of a bridge loan which must be paid back in 90 days at 18 percent interest.
>
> We borrowed this money believing the RAP was still in effect. Now we are faced with the possibility of losing not only our new home, but also the older home, because it is absolutely impossible for us to pay the payments on both houses and the bridge loan also.
>
> We are middle-aged people who have worked very hard to build up an equity in our home, and now it seems unbelievable that we may lose everything we have worked so hard to acquire for the past 27 years.
>
> Our home is not overpriced, and it is a good house in a very desirable, middle-class neighorhood. We believe the only reason it has not sold is because of the high interest rates.

But home buyers and home sellers are not the only ones affected. What about renters? With the high cost of interest, the rental market has suddenly become a very heavy demand area in Frederick County. In my own office alone, I have seen townhouses, I rented last years for one price—now I am renting those same town homes $100 per month more per month.

Employers—I am in real estate. Why am I mentioning employers? I would like to read, again, a portion of a letter from one of the largest corporations in the world in communication industry, located in Frederick County.

> A compounding effect of this situation on our business is extraordinarily high cost of transferring personnel. Frederick Electronics is a high technology, Maryland-based corporation with customers in 75 counties, worldwide.
>
> In order to succeed in this highly competitive marketplace, we must have the services of top professionals. Moving those professionals to the State of Maryland and providing them with adequate housing has become prohibitively expensive.
>
> I cannot see how our company and others in similar growth industries will continue to grow and prosper if long-term interest rates remain at their current high levels for much longer.
>
> I urge you to use your good offices to encourage a more moderate and balanced monetary policy, which, if coupled with government fiscal responsibility, I am sure will result in a better quality of life for us all.

Who remains that does not feel this impact of high interest rate? No one—buyers, sellers, renters, business, industry, counties, State, Federal Government, we are all feeling this impact of high interest rates. It will also affect our children of today, whose American dream of homeownership might be a thing of the past in 20 years.

Thank you, Senator.

Senator **Sarbanes**. Thank you for a very strong and powerful statement.

Mr. Ross, please proceed.

STATEMENT OF DALE ROSS, ROBERT L. GRUEN, INC., ROCKVILLE, MD., AND MEMBER, MONTGOMERY COUNTY BOARD OF REALTORS, INC.

Mr. Ross. My name is Dale Ross. I represent 40 members of the Montgomery County Board of Realtors.

To reiterate what Peggy was saying, we, as real estate people, are in very unique positions. We see the buying public prior to them going to lenders or going elsewhere to seek their financial services. As a result, being on a grassroot level, we see these people and talk to these people on a daily basis. We find out what their economic background, what their problems are in making decisions buying houses today.

The No. 1 problem, obviously, is interest rates, and that's why we're here. In Montgomery County we have thousands of people out there, thousands of buyers even today, this month, looking for houses. They're looking, and looking, and looking, and they go into shock when they see the prices' relationship to the interest rates. This is affecting not only resale properties but new construction across the board. There are thousands of sellers out there, homeowners that are carrying mortgages in one, two, possibly even three properties, in a domino effect, they can't market their properties.

The interest rate problem is, you don't realize it as the public until you're in the markets. Most people today cannot afford to buy back their own houses. Because you're paying $200 or $300 on your own existing mortgage, when you go out and look at that same house today, that could be $1,500 a month to carry that same house. However, people do need shelter. There are other durable goods that they could take and postpone making decisions on buying, or taking that washing machine and having it repaired, instead of buying a new one.

However, when your family size increases or decreases, you have to have a change. In our area in Montgomery County, we have a lot of people that are transients, as the Washington metropolitan market does. These people are transferred with new job positions or out with new job positions, and many times they're affected, because they can't sell their house to leave the area. They can't buy a house coming into the area.

Young people today are being adversely affected by these interest rates. It used to be in the 1970's, the early 1970's, it would take two incomes. The spouse would go back to work. It took two incomes to qualify for that mortgage. In the late 1970's and early 1980's, last year it took the two incomes plus usually a parent or somebody else cosigning a loan, because the bank said: "Look, you just don't qualify. If you can make the payments, fine, but we need the guarantee. Somebody to cosign it."

I don't know what's going to happen next year. You're out of ideas. You can only cosign the loan. You can have two incomes. Maybe people will have three incomes. This is changing the social structure.

Young people who want to have families have to postpone that decision, because as one person told me yesterday, it's another mouth to feed and a loss of income, and it just doesn't correlate to go in to turn around to try to make mortgage payments. Today many homebuyers are getting into a situation which some feel is dangerous, with balloon notes for mushrooming payments, where you get a mortgage for 3, 4, or 5 years. It's a $100,000 mortgage. And you owe $100,000 at the end of a short period of time.

There are mortgages out today where your payments increase per month or per year, and then you have to go back and requalify, and if you have a family or lose an income, you just qualify with two incomes. How are you going to qualify for the same mortgage with a loss of income. It's affecting middle aged people as well who want to move up or who want to sell their existing properties. They're forced not to do that. They can't move their existing properties to go purchase a new one with, to unlock their equity.

It's hurting older people who want to retire but can't afford to move. They want to retire and, say, go to Florida, for instance. They can't afford to fly down there, and they can't afford to sell their property here.

We used to define years ago, which was a couple of years ago, "house poor," as being you couldn't afford furniture or you couldn't afford the extra appliance in the house. Today "house poor" is redefined as you can't afford the mortgage payments, and that is a sad commentary.

We have today not only the problem with the public, we have the problem in industry. There are real estate brokers in this county that are going out of business left and right. Many real estate operations are run on a limited capital reserve situation to begin with. Once the market takes a dip or expenses rise like they have, the small businessman just can't stay in business.

Across the board, most brokers have felt that 20- or 22-percent increase in expenses over last year. We just got notified, for instance, in a local paper in Washington that their rates are going up 10 percent as of October 1. Well, that 10 percent has to come from somewhere. If our sales in the county are down 37 or 50 percent in some offices, it's got to come from somewhere to meet those expenses. Many companies need 8 to 10 sales a month just to break even, and that's before the onwer operator takes their profit out.

Those offices today are doing there and four sales a month. This thousands of dollars a month that has to come out somewhere to meet the operating expenses before profit either is borrowed short term, as if I would go into a bank and borrow at 1 or 2 percent above prime on a floating rate, hoping I can pay back the interest, never mind the principal on the loan, or I can dip into my own pocket and take the money out of my own personal savings to subsidize the operation. Well that can only go so far, because the well is only so deep.

You're seeing more and more people, more and more agents and more and more companies going out of business. In Montgomery

County our membership is down 13 percent from the first of the year. We have lost 25 brokers and 35 offices have closed. We are down to a membership of 4,600 and continuing to decrease.

I have some charts[1] which I think would illustrate this much more effectively.

The average house in Montgomery County is projected to be approximately $115,000 by the end of the year—which is off the chart. I hate to say what it will be 6 months from now. [Laughter.] Approximately $115,000 is what we're looking at as the average income—the average sale price for a piece of property, purchase price would be approximately $115,000 by the end of the year. This graph indicates new sales, as well as resale properties.

As you indicated earlier, it's going to be off the graph pretty soon.

The next chart we have is "Gross Mean Income," and the average income in the county will be or is projected to be by the end of this year approximately $41,000.

Keeping in mind the average price will be $115,000, the average income will be almost $41,000.

The next chart will illustrate what is probably called creative financing. There are some people in the industry that feel creative financing is the answer or same-all to all the problems in real estate, really is not. Creative financing is based on the assumption, if you will, that the seller or somebody can help out that buyer either by loading back his equity, or her equity in the house, or by putting a second trust on that property with an assumable loan.

The assumptions raised, as this chart indicates, have gone up over 100 percent, where the owner take-back loans have gone to approximately 91 percent. This is significant, because there are not that many people, numberwise, that can afford to do this. Most sellers sell their property and need the equity either to retire with or pull out to invest in another piece of real estate. Those sellers that do have the ability are selling their property, and those are the homes that are moving today with the assumable loans.

The problem we also have today with creative financing is, many loans are not assumable which is cutting down that. And also the gap because of prices of property on what is an assumable loan, and the cash above that the buyer needs is so significant that most purchasers cannot put $50,000 or $60,000 down for the average house, because those loans 3 or 4 years ago represented 80 percent of the value, and today 80 percent of the value. There's a $40,000 or $50,000 play figure in there, and the cash isn't there for the buyer to assume the loan in the lower interest rate, which is to make the payments on and to put the cash above to make the sale.

The next chart indicates unit sales at the Montgomery County board of Realtors. I believe it's pretty obvious with all the press it's been getting recently, sales are going down. There's no question about it. As sales increase, as operating expenses in an office increase, something has to break. And what's happening is agents are going out of business. Brokers are closing offices, and there is just no hope of anything happening in the near future.

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[1] The charts referred to by Mr. Ross may be found beginning on p. 203.

When we used to borrow short term, if we needed it to operate a business, we could see at the end of 6 months, or 5 months, or 4 months, it would be a turnaround. We have almost a 12-month market or did have in the Montgomery County area. It was somewhat seasonal, but it was really 12 months, so if we had to carry ourselves over the winter and borrow short term, we knew we could pay back April or May with sales.

It just isn't happening. We have no spring market, and we haven't had for awhile.

This next chart, I believe, really tells it all, if you will. It is a comparison. If you start on the left-hand side, this was an average sale price for a house back in 1978. This is what a buyer goes through, and this is what an agent goes through, and a lender goes through to try to figure out how somebody qualifies at a $79,100 sale price. If the average buyer put 20 percent down in 1978, took out an 80-percent mortgage, they would need a $63,280 loan. Interest rates back then were 12 percent for a 30-year mortgage.

The monthly payments are broken out into principal and interest, real estate taxes, and insurance on a monthly basis, which shows that $725 per month expenditure to carry that house prior to utilities. One would need a $31,100 income to qualify for that loan.

The second side of the chart is an average sale price today. $115,000 in county. Again, using the same percentages, 20 percent down represents $23,000. A new 80-percent mortgage represents $92,000 at a 17-percent level, and this graph was down last week. That's now 18 percent. We don't know how many years. It could be a 3-year note; it could be a 5-year note, a 10-year note. But on a 30-year payment plan, if it was, would be $1,311.62 interest and principal. Added to taxes and insurance, you come up to $1,430 per month to carry that house, prior to utilities.

That is a $61,300 income to qualify for that average house. You would need a 49-percent increase in your annual income to qualify for the average house. And that's the problem. Most people's income have not doubled. And that 1978 example is with two incomes. Unless you have a business that's been on the increase or unless you have come into a lot of money recently, your income hasn't doubled in that period of time. That same house—this is an average house.

The next chart or next display takes the 17-percent example on the left-hand side and just reiterates it, showing the $61,300 income required for that $1,430 payment on the average house. The right-hand side represents at a 12-percent level, if interest rates remained at 12 percent or dropped to 12 percent, the average house now would cost a $92,000 loan, $946 and change, principal and interest, at a $1,065 a month principal and interest. Required income would be a little less than $46,000 to qualify for that loan.

This is what's happening in today's market. The 17- or 18-percent rates are simply chosen people that can't carry the house no matter how much they try, no matter how they look, the dollars just aren't there.

Thank you.

Senator SARBANES. Well, I want to thank both of you. Those were very effective, very comprehensive statements. And really, you have covered in a very careful way virtually every question I might have asked.

Let me just very quickly ask what percentage of homes today involve some kind of owner financing?

Ms. **Lekstrum**. To make a sale, you have to have at least 90 percent homeowner financing, somehow or another. The ones that don't have any owner financing, creative financing or assumables, you will find staying on the market over a year.

Senator **Sarbanes**. When you have assumables or owner financing, is something then reflected in the selling--does the selling price go up, if not commensurably, at least to some extent, thereby boosting the cost of the home?

Ms. **Lekstrum**. Definitely.

Senator **Sarbanes**. You contribute to inflation twice. One, the high interest rate and, two, the boost in housing costs.

Mr. Ross. There's a theory there will be a two-price or two-tier level pricing very shortly, if they haven't seen it already. Identical houses next door to each other, let's say, $115,000, for example. That buyer would have to go out and seek their own financing at the market level. The house next door might be $125,000 for an identical house with that owner willing to hold the financing at 12 or 14 percent, and it will be a premium. And the purchasers will flock to the second house to get that mortgage payment down to a level they can handle.

Senator **Sarbanes**. Now, of the people who are required to move, what percentage are in a situation where their company or whoever requires the move can cover the crisis? Do you have any idea about that?

Mr. Ross. The large companies took a philosophy that when they move corporate executives or middle managment that they would pick up either housing costs or the front end or the new end and some of the related costs of settling. They've done two things. One, corporations have cut back transferring executives. The second thing they've done is either gone to people to try to guarantee the house wherever it might be—in Minnesota, let's see. Guarantee that house. Somebody's saying, "We will buy that house for dollars and take in the loss."

I think there was an article in Business Week a couple of months ago that said the average executive costs about $40,000 a year to transfer, which was $26,000 2 years ago.

Senator **Sarbanes**. That's an advantage which large businesses have over small business, because they have the money and small businesses don't. They're at a disadvantage in trying to attract the talent, which is another point bought out on occasion.

Mr. Ross. I also have a press release as well as some letters that I'd like to enter into the record from our membership.

Senator **Sarbanes**. We'll be very happy to have your submissions for the record.

[The letters, together with the press release referred to by Ms. Lekstrum and Mr. Ross, follow:]

COLONIAL MORTGAGE SERVICE COMPANY
ASSOCIATES, INC.
AMBER MEADOWS PROFESSIONAL BUILDING, SUITE 13
198 THOMAS JOHNSON DRIVE
FREDERICK, MARYLAND 21701
TELEPHONE: (301) 663-1000

September 1, 1981

Ms. Peg Lekstrum
Frederick County Board of Realtors
North Market Street
Frederick, Maryland

Dear Ms. Lekstrum,

Here it is the end of the summer and the interest rates have given no signs of easing, and am expecting the FNMA auction results today to be over eighteen percent. In trying to service the financial needs of this market area, specifically the Frederick area, it demands attention be paid to all types of lending institutions for what is available for the borrower. The local banks are being more conservative than in the past, and of those banks and savings and loan institutions there are only a few that are participating in the secondary markets.

I am finding business has fallen off over 50% in the past two [illegible] compared to a year ago. According to HUD's area office, last week's applications numbered 44, compared to last year's figures of 65 per day. The alternative mortgage instruments, such as FNMA's Resale and Buydown programs are about the only way purchasers, other than owner takebacks, are able to buy. Generally, people want to know one thing, what is the dollar fiqure per month. Although Colonial has not been offering adjustable rates, variable rates and the shared appreciation mortgages, I have noticed them in the market place during the past year. The question that is raised in talking of these previously mentioned AMI's, is where will the payments of them be in a year and will the ability of the mortgagor to repay the mortgage still exist.

Contracts are written on Federal Housing Administration and Veteran Administration loans to be settled at the maximum prevailing rate that is in effect at the time of settlement, and many prospective borrowers find themselves going from an initial 14% contract rate to a 17% rate at settlement. In the 1980 Housing Bill, a trial program was authorized whereby FHA allows ten percent or a specific number of mortgages be financed where the lender and the borrower agree to a specified rate and thereby eliminating the prevailing rate problems. This would also help eliminate the renegotiating of the discount points that is important to the seller. But sellers aren't interested in government loans when the points are higher than 4, even though the number of qualified buyers are higher. Points, since the beginning of the year, have been erratic going from 3 to 8 points during the first two months until the rate was increased to 14%, a ½% increase; the first two

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weeks in March showed improvement to a 3 point market, but then fell away to 8½ and on April 10th the rate flipped to 14½%, another ½% increase; the points continued to increase after the rate increase until they were 12 in May, and the rate was increased again, this time a full percent, to 15½. The market remained workable until the end of June, at which time, and since then, except for immediately after the rate flips, the points have remained above six. Since there is a 60 day lag between application and settlement, loans are still being closed, but do expect to do little business in the months ahead without some period of relief.

Many of the things that are helping the financing industry, when it comes to mortgages, can be said to be innovative, creative and necessary to aid people in buying homes. The tax advantage of home ownership, the ability to qualify are diminishing to a point where people are not buying. In this county we are a growth area, but we cannot grow, people cannot buy houses, sellers cannot sell, and banks do not have funds to lend, and those of us that do, are requiring yields of between 16½% to 18%. Everybody is waiting, except for those that can't afford to wait, or sellers that must move, therefore they take risks in holding mortgages themselves, or they adjust prices to cover financing costs, which is inflationary, or builders go out of business, or sellers sell under-priced to relocation services. In the past few days, I have found that one of the area's relocation specialists now hold almost twenty houses - vacant! Another recently closed a transaction where they will lose a substantial amount due to market conditions. The question then raised is, how long will they continue to take these losses to sell houses.

A number of clients which closed loans in the past two years under the graduated payment loans are having tremendous difficulties, and foreclosures are up. More and more of my time is spent in counseling, and advising clients, sometimes to dispose of the properties that have made them "house poor". The effects of this "house poor" situation lead to credit problems, as well as, family problems.

It has always been the American Dream to own a home, but most that have been in the buying market in the past year are finding that the dream is turning into a nightmare. Relief is needed, and needed now!

I remain,

Sincerely,

COLONIAL MORTGAGE SERVICE COMPANY, INC.

Judy G. Harris

Judy A Harris
Assistant Vice President

PLANTRONICS
Frederick Electronics

James D. Lakin
President

August 28, 1981

Senator Paul Sarbanes
Senate Office Building
Washington, D. C.

Dear Senator Sarbanes:

We have now lived with high interest rates for the better part of a year. Not only have short-term rates climbed over the twenty percent mark, but long-term rates, a bellweather of anticipated future inflation, have remained high, making the acquisition of new homes prohibitive for all but the truly wealthy. It is obvious from recent financial news that this strategy has had little effect on inflation and has merely served to stagnate the economy.

A compounding effect of this situation on our business is the extraordinarily high cost of transferring personnel. Frederick Electronics is a high technology, Maryland corporation with customers in seventy-five countries world-wide. In order to succeed in this highly competitive marketplace we must have the services of top professionals. Moving those professionals to the state of Maryland and providing them with adequate housing has become prohibitively expensive. I cannot see how our company and others in similar growth industries will continue to grow and prosper if long-term interest rates remain at their current high levels for much longer.

I urge you to use your good offices to encouage a more moderate and balanced monetary policy which, if coupled with government fiscal responsibility, I am sure will result in a better quality of life for us all.

Very truly yours,

James D. Lakin

JDL/gm

PLANTRONICS
Frederick Electronics

September 1, 1981

Senator Paul Sarbanes
Senate Office Building
Washington, D.C.

Dear Senator Sarbanes:

The level of interest rates for home mortgages has further hindered the already difficult task of recruiting professional employees into the Frederick Maryland area.

As in the case of most employers, Frederick Electronics does not significantly help a potential employee moving from out-of-state when it comes to paying mortgage differentials. As a result, we often talk to qualified applicants who we make offers to only to have a rejection because of the fear of not being able to sell a home elsewhere or not being able to handle to extremely high monthly interest rates on comparable housing in Maryland.

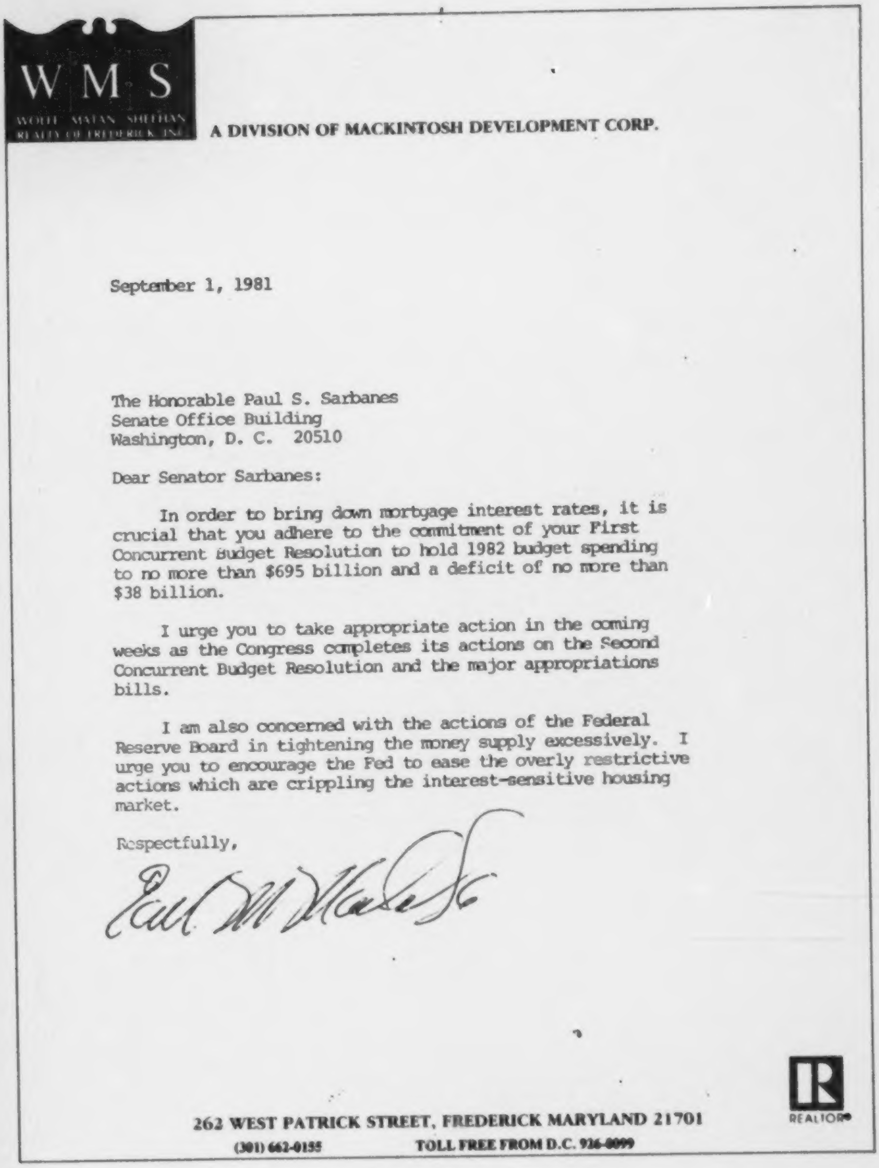
We strongly support any legislative action which would alleviate this problem and allow Americans to again pursue the job of their choice and help Maryland grow.

Sincerely yours,

Richard M. Horch
Director, Employee Relations

RMH/gm

Frederick Electronics Corp | P.O. Box 502, Hayward Road | Frederick, Maryland 21701 | 301/662-5901 | Telex: 893423 & 893438



WMS
WOLFF MATAN SHEEHAN
REALTY OF FREDERICK INC.
A DIVISION OF MACKINTOSH DEVELOPMENT CORP.

September 1, 1981

The Honorable Paul S. Sarbanes
Senate Office Building
Washington, D. C. 20510

Dear Senator Sarbanes:

In order to bring down mortgage interest rates, it is crucial that you adhere to the commitment of your First Concurrent Budget Resolution to hold 1982 budget spending to no more than $695 billion and a deficit of no more than $38 billion.

I urge you to take appropriate action in the coming weeks as the Congress completes its actions on the Second Concurrent Budget Resolution and the major appropriations bills.

I am also concerned with the actions of the Federal Reserve Board in tightening the money supply excessively. I urge you to encourage the Fed to ease the overly restrictive actions which are crippling the interest-sensitive housing market.

Respectfully,

262 WEST PATRICK STREET, FREDERICK MARYLAND 21701
(301) 662-0155 TOLL FREE FROM D.C. 926-0099
REALTOR®

FREDERICK, MD.
(301) 694-0550

WILLIAM G. BOWEN
REAL ESTATE APPRAISER AND CONSULTANT
228 WEST PATRICK STREET
FREDERICK, MARYLAND 21701

HAGERSTOWN, MD.
(301) XXXXXX
293-4242

August 28, 1981

Senator Paul S. Sarbanes
2327 Dirksen Senate Office Building
Washington, D. C. 20510

Dear Senator Sarbanes:

As you well know, the current high interest rates have severely slowed the housing market, both in housing starts and existing units. The ripple affect has effected hundreds of thousands of people in the industry and more would-be buyers and sellers.

I am in support of anything that can be affectively done to reduce the current high level of interest rates. Hopefully, there is a solution that will not increase the government dole and not be inflationary.

Sincerely,

William G Bowen

William G. Bowen
Appraiser - Counselor

FREDERICK COUNTY HOME BUILDERS ASS'N.
Four East Church Street, Suite 100
Frederick, Maryland 21701
(301) 663-3599
(301) 831-9177

KEN AND WENDY BRUCHEY, POTENTIAL HOME BUILDERS
271 Pinoak Lane
Frederick, Maryland 21701

My wife and I first entered the real estate market in November of 1977, when we negotiated a contract for the purchase of our present home in Frederick. At the time, the market was bustling, and mortgage loans were fairly simple to secure. We shopped around, found the best deal, and got financing--all within a week's time. I felt we had gotten a good deal; a $35,000 mortgage at 9 per cent for 30 years, payments amounting to $293.72. Our intentions were to stay in this house for three to five years, then sell it and build a house.

In August of 1980, we had managed to save a sizeable amount and decided now was the time to set our building plans in motion. After several months of searching, we found just the right building lot--2.5 acres in a small, secluded subdivision west of Middletown, Maryland, at the foot of South Mountain. In October of 1980, we put $10,000 down and financed the remainder of the $21,000 purchase price at 11 per cent for 10 years with the realtor. Payments on this loan came to $179.08. Combined with our mortgage payment, we were still able to save some money each month. Again, I felt it was a good deal for us, and financing was relatively easy to obtain. We felt we were right on schedule for a early Spring 1981 groundbreaking.

In the ensuing months, we searched for just the right builder--one we felt could build us a quality, energy-efficient custom home at a price we could afford.

In January of 1981, we settled on a builder and began the tedious and time-consuming process of drawing up plans for our new home. When we started this process, the interest rates were fairly steady at about 13½ per cent. Our intentions were to begin building and sell our house later, so we would not have to find temporary housing.

It took us an extra three to four weeks to get our plans to the point where we felt comfortable, and in that time span the interest

AFFILIATED WITH NATIONAL ASSOCIATION OF HOME BUILDERS AND STATE OF MARYLAND INSTITUTE OF HOME BUILDERS

rates soared from 13½ per cent to the 15½ - 16 per cent range.

Now we were faced with two problems. Even with two above-average incomes and no outstanding debts, we could no longer qualify for a loan at the inflated interest rates, and our home--an immaculate, affordable, split foyer, suddenly became unaffordable to the average buyer.

Our home has been listed with a large national realtor for five months, and in that time the interest rate has continued to climb to the present 17 - 17½ per cent level. We are asking a fair price for a nice property and cannot get a buyer who can qualify for a mortgage with present conditions. Our agent has told us time and again that the only properties which are selling are those with assumable mortgages. At the time we purchased our present home, we had never even heard of an assumable mortgage and our bank will not allow an assumption of our present loan.

As I write this, the prospects for improvement in the housing market are quite poor. The investment we had depended upon to enable us to build our dream house has become unmarketable--solely because of the absurd interest rates. Banks and Savings and Loans Associations have recently told me they don't even want to talk to potential customers about building loans! In short, we are being denied our dream of building our own home because of the ridiculous conditions existing in the financing industry.

I do have one thing to be thankful for, however. Unlike some of my acquaintences, I haven't been transferred at my place of employment and forced to leave my house sitting empty while simultaneously paying rent on a new residence along with the mortgage payments on my house.

The housing situation in the United States today has reached a crisis point. When buyers can't buy, sellers can't sell, and builders can't build, its time for something to be done; after all, we each need a place to call home.

# # #

REALTOR®

News Release

NATIONAL ASSOCIATION OF REALTORS®

Montgomery County Board of Realtors, Inc.
3809 Farragut Ave. P.O. Box 270
Kensington, Maryland 20795
Telephone 301 933 [illegible]

September 1, 1981
(Edith Donohue - 933-8484)

I COULDN'T AFFORD MY OWN HOUSE TODAY

"To buy a home today comparable to an $80,000 home in 1978 would require a 49% increase in income over the past three years," Realtor Dale Ross told Senator Paul Sarbane's at his public hearing on the impact of high interest rates.

Representing the Montgomery County Board of Realtors, Dale Ross, along with Peggy Lekstrum, told the Subcommittee on Investment, Jobs and Prices of the Joint Economic Committee that 17% interest rates are prohibiting potential homebuyers from obtaining a mortgage. "Only 4% of the population today can qualify for a conventional loan," he said.

"Three years ago, a working couple could afford an average home of $80,000. Today that same couple will need further financial assistance, such as a co-signer or a third income, in order to borrow. "

Ross acknowledged that rising prices are partly to blame. The cost of a home has gone up 50% in the last three years. But, he pointed out, "interest rates have also risen dramatically - by 42%, causing monthly payments on a mortgage to double." If interest rates receded to 12%, a family with a $46,000 income could qualify for a $115,000 home. "With interest rates at 17%," Ross said, "that family must earn $61,300.

There are thousands of people in the market today who are anxious to purchase, but they cannot afford the monthly payments. This is turn affects those persons anxious to sell such as older people who might wish to dispose of their large home and move to a warmer climate. "In fact," said Ross, "an owner couldn't even afford to buy his own home today if he had to."

Creative financing has helped considerably over the past two to three years in providing the necessary funding, but creative financing needs a seller who is willing to participate in the financial arrangements with a buyer and not all sellers can afford to become lenders or bankers.

In order for the housing market to revive, interest rates must come down. The industry will ask its members to write or telegraph the Federal Reserve Board on September 8th to express their alarm at the continuous high rates caused by its monetary policies. It is urged that potential home purchasers and sellers join Realtors in asking for relief.

1978

AVERAGE PURCHASE PRICE: $79,100

CASH DOWN: $15,820
(20% OF VALUE)

NEW MORTGAGE: $63,280
(80% OF VALUE)

LOAN: $63,280 AT 12% ANNUAL INTEREST FOR 30 YEARS

MONTHLY PAYMENT:

$650.91	PRINCIPAL + INTEREST
65.92	REAL ESTATE TAXES
8.17	INSURANCE
$725.00	PER MONTH

REQUIRED INCOME TO QUALIFY FOR LOAN: $31,100

1981

AVERAGE PURCHASE PRICE: $115,000

CASH DOWN: $23,000
(20% OF VALUE)

NEW MORTGAGE: $92,000
(80% OF VALUE)

LOAN: $92,000 AT 17% ANNUAL INTEREST FOR ?? YEARS

MONTHLY PAYMENT:

$1311.62	PRINCIPAL + INTEREST
95.88	REAL ESTATE TAXES
22.55	INSURANCE
$1430.00	PER MONTH

REQUIRED INCOME TO QUALIFY FOR LOAN: $61,300

*** FROM 1978 TO 1981 A 49% INCREASE IN INCOME IS REQUIRED TO QUALIFY FOR AN AVERAGE LOAN ***

17% INTEREST RATE

AVERAGE PURCHASE PRICE: $115,000

CASH DOWN: $23,000
(20% OF VALUE)

NEW MORTGAGE: $92,000
(80% OF VALUE)

LOAN: $92,000 AT 17% ANNUAL INTEREST FOR ?? YEARS

MONTHLY PAYMENT:

$1311.62	PRINCIPAL + INTEREST
95.83	REAL ESTATE TAXES
22.55	INSURANCE
$1430.00	PER MONTH

REQUIRED INCOME TO QUALIFY FOR LOAN: $61,300

12% INTEREST RATE

AVERAGE PURCHASE PRICE: $115,000

CASH DOWN: $23,000
(20% OF VALUE)

NEW MORTGAGE: $92,000
(80% OF VALUE)

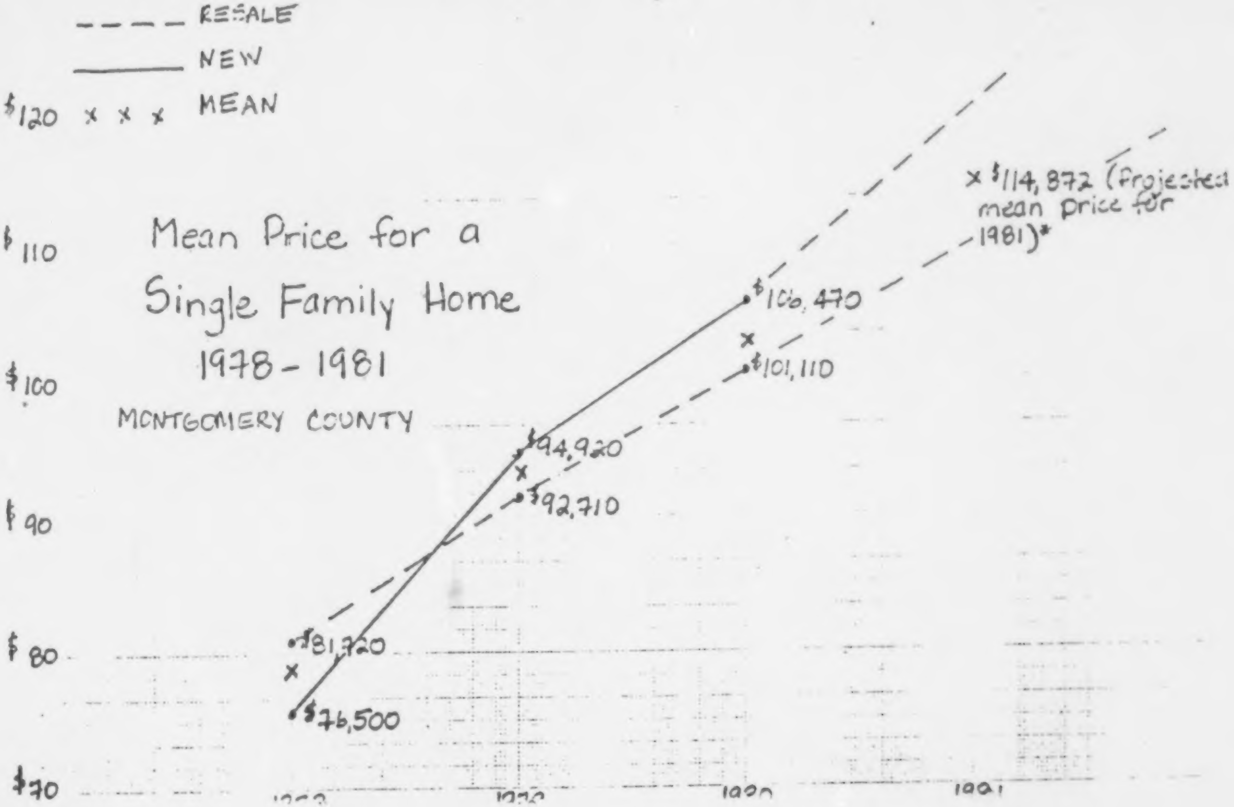
LOAN: $92,000 AT 12% ANNUAL INTEREST FOR 30 YEARS

MONTHLY PAYMENT:

$946.32	PRINCIPAL + INTEREST
95.83	REAL ESTATE TAXES
22.85	INSURANCE
$1065.00	PER MONTH

REQUIRED INCOME TO QUALIFY FOR LOAN: $45,750

1

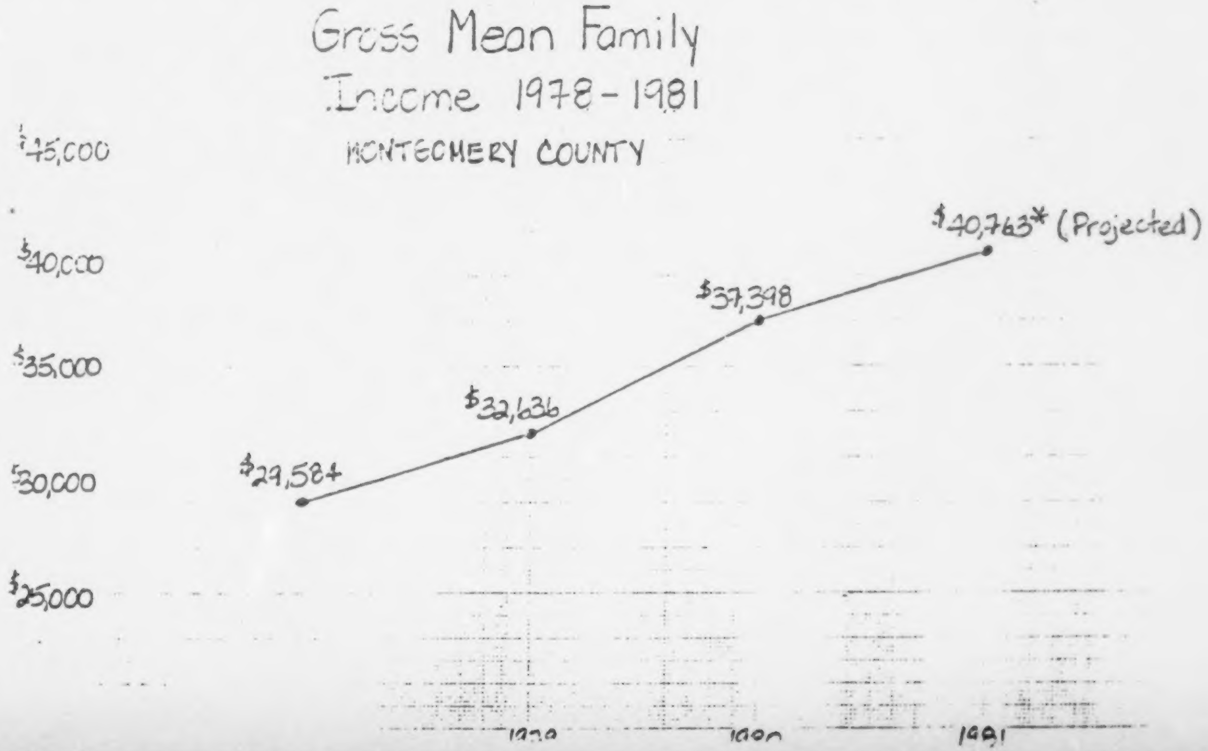


Mean Price for a Single Family Home 1978 - 1981

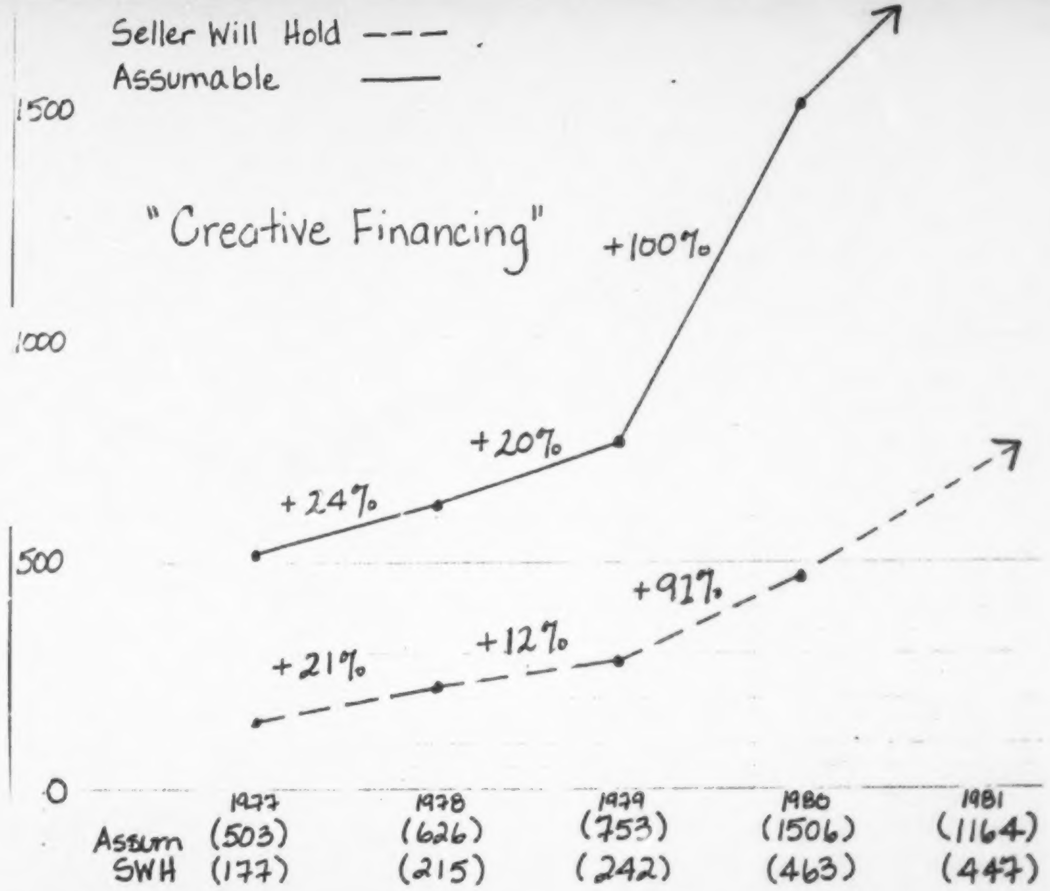
MONTGOMERY COUNTY

Source: Md. Nat'l Capital Park & Planning Commission

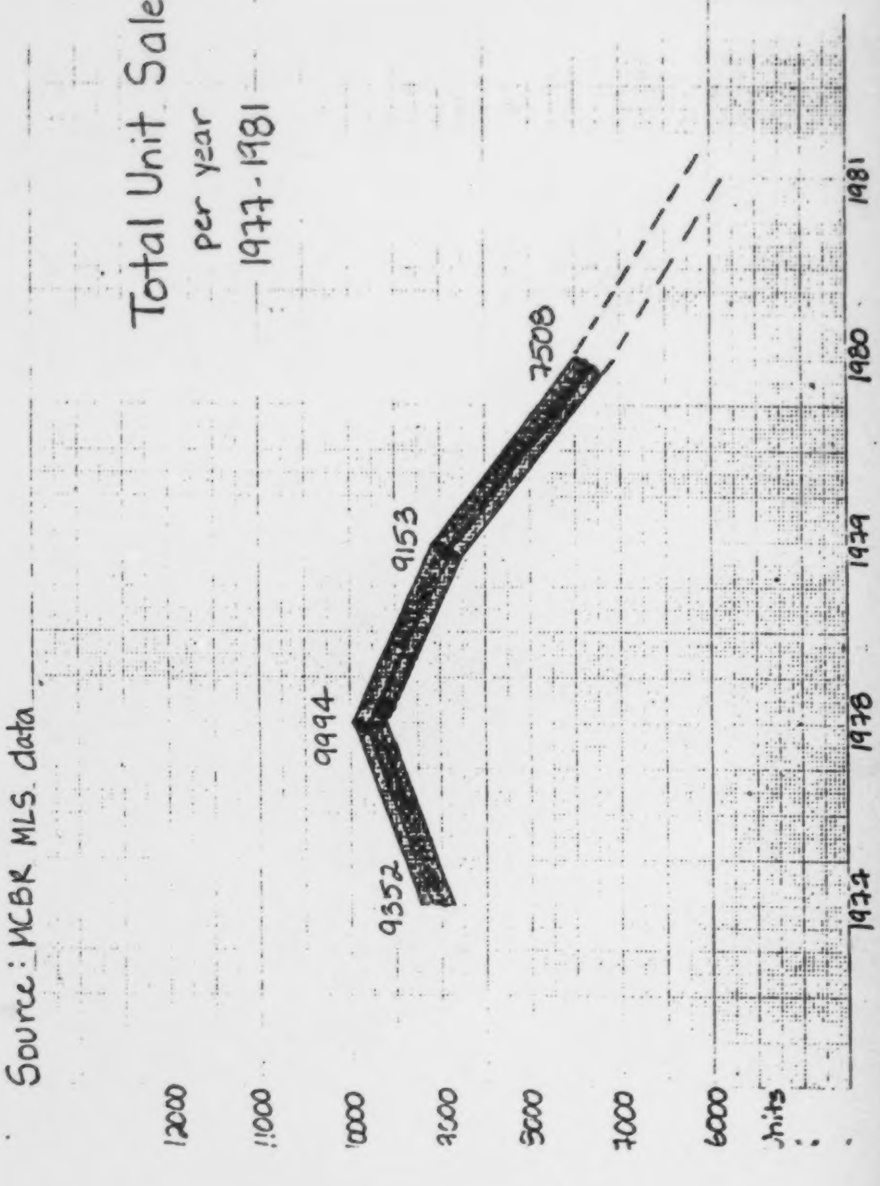
Source: U.S. Dept. of Commerce



Gross Mean Family Income 1978-1981
MONTGOMERY COUNTY


Seller Will Hold - - -
Assumable ———
"Creative Financing"
1500
1000
500
0
+24%
+20%
+100%
+21%
+12%
+91%
1977
1978
1979
1980
1981
Assum (503) (626) (753) (1506) (1164)
SWH (177) (215) (242) (463) (447)

4



Total Unit Sales
per year
1977-1981

Source: MCBR MLS data

Marie D. Heintz, G.R.I.
ASSOCIATE BROKER

LEE FREW PLATT, REALTORS
3514 PLYERS MILL ROAD
KENSINGTON MARYLAND 20795

(301) 933-9000
RES 933 0400

HISTORY OF THE FRUSTRATIONS OF THE
OWNERS AND LISTING AGENT OF THE
PROPERTY AT 1336 CHILTON DRIVE
SILVER SPRING, MD.

February 22, 1981	Property listed for sale - $119,500
February 23, 1981	Letter sent to Loyola Federal Savings and Loan requesting info as to assumability, terms, etc. of existing loan
March 5, 1981	Loyola Federal Savings and Loan notified lister that loan was not assumable
March 23, 1981	Price reduced to $112,000
April 2, 1981	Lister contacted Loyola Federal Savings and Loan, was told 85% of loan had been sold to Metropolitan Life Insurance Company which had not permitted loan to be assumed.
April 2, 1981	Lister placed call to head of Mortgage Department at Metropolitan Life and wrote letter suggesting various means of creative financing the company might consider. Was told loan was not assumable and "don't call us - call Loyola".
May 14, 1981	Price reduced to $107,000 - now below market
May 15, 1981	Letter from Loyola Federal confirmed telephone conversation with Metropolitan Life.
June 15, 1981	Letter from Loyola notified lister loan was now assumable at 1% below market rate but with no second trust.
July 1, 1981	Owners moved to new home in Chicago, Illinois.
July 5, 1981	Phone call from Loyola Federal (inspired by frantic conversation with lister) revealed Metropolitan Life Insurance Company now w[illegible] allow a second trust with 90% exposure and reducing allowable interest rate at 14½%.
August 1, 1981	Owners now begin making double payments on [illegible] houses.......more than $3,000 per month. [illegible] soon be forced to let h[illegible] to foreclosure.

4422 Harford Ave
Beltsville, Md
20705

Senator Paul Sarbanes
U.S. Senate
Wash. D.C.

Dear Senator Sarbanes:

For the past four months we have been trying to sell our home in Monrovia Md. (Frederick County). We have had numerous possible buyers look at our home, but because of the high interest rates now, we have been unable to find a qualified buyer.

We recently signed a Contract with a qualified buyer and two days later the bank removed the "wrap" which now makes it impossible for the people to buy the house.

The very day the bank removed the wrap, unbeknown to us, we borrowed $49,000.00 from another bank in order to make the settlement on our new home in the form of a bridge loan, which must be paid back in 90 days at 18% interest. We borrowed this money believing the "wrap" was still in effect. Now we are faced with the possibility of losing not only our new home but also the old home, because it is absolutely impossible for us to pay the payments on both houses, and the bridge loan also. We are middle aged people who have worked very hard to build up an equity in our home, and now it seems unbeleivable that we may lose everything we have worked so hard to acquire over the past 27 years.

Our home is not overpriced and is a good house in a very desirable middleClass neighborhood. We believe the only reason it has not sold is because of the high interest rates.

4

There certainly should be something you and others in your position could do to get the interest rates back down to a reasonable level so situations such as this would not be happening.

Our son is a high school senior and if we should lose these houses it will be impossible for us to send him to college as planned. We are sure you realize this will effect his future in a very serious way.

We ask your help in trying to get this outrageous situation under control quickly.

Yours truly,
Ellwood Frey
Eileen M. Frey

FRAZEE ASSOCIATES, INC. Realtors

1776 PLAZA, 1776 EAST JEFFERSON STREET
ROCKVILLE, MARYLAND 20852
(301) 881-9000

September 1, 1981

Dear Senator Sarbanes:

I am a registered voter and licensed Realtor (BROKER) ~~Associate~~ living in Montgomery County.

The real estate industry has been put in a crisis situation by high interest rates.

Both the past and present administrations have pursued for almost two years a high interest rate policy which has not worked, but is actually adding billions of dollars a year to the cost of government. This policy has caused countless failures in business. People can no longer invest in homes, automobiles, farm equipment, business, furniture and the necessities of life because of high interest rates.

The future of thousands of Maryland citizens are at stake. Please help.

Very truly yours,

Harris Frazee
1 COATBRIDGE COURT
OLNEY, MARYLAND 20832

FRAZEE ASSOCIATES, INC. Realtors

1776 PLAZA, 1776 EAST JEFFERSON STREET
ROCKVILLE, MARYLAND 20852
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The future of thousands of Maryland citizens are at stake. Please help.

Very truly yours,

Elizabeth St John
14316 Gaines Ave
Rockville Md 20853

FRAZEE ASSOCIATES, INC. Realtors

1776 PLAZA, 1776 EAST JEFFERSON STREET
ROCKVILLE, MARYLAND 20852
(301) 881-9000

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The future of thousands of Maryland citizens are at stake. Please help.

Very truly yours,

Debra Hartig
7420 Westlake Terr
Bethesda, Md
20817

FRAZEE ASSOCIATES, INC. Realtors

1776 PLAZA, 1776 EAST JEFFERSON STREET
ROCKVILLE, MARYLAND 20852
(301) 881-9000

September 1, 1981

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The future of thousands of Maryland citizens are at stake. Please help.

Very truly yours,

Marcia Rabinoff
1131 Univ. Blvd
Silver Spring, Md

FRAZEE ASSOCIATES, INC. Realtors

1776 PLAZA, 1776 EAST JEFFERSON STREET
ROCKVILLE, MARYLAND 20852
(301) 881-9000

September 1, 1981

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The future of thousands of Maryland citizens are at stake. Please help.

Very truly yours,

Sandra Poms
9 Leyton Ct.
Rockville, Md

FRAZEE ASSOCIATES, INC. *Real*[illegible]

1776 PLAZA, 1776 [illegible]
ROCKVILLE, [illegible]
(301) [illegible]

September 1, 1981

Dear Senator Sarbanes:

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The future of thousands of Maryland citizens are at stake. Please help.

Very truly yours,

Lynda S. Keller

LYNDA S. KELLER
510 HARDING DRIVE
SILVER SPRING, MD 20901

FRAZEE ASSOCIATES, INC. Realtors

1776 PLAZA, 1776 EAST JEFFERSON STREET
ROCKVILLE, MARYLAND 20852
(301) 881-9000

September 1, 1981

Dear Senator Sarbanes:

I am a registered voter and licensed Realtor Associate living in Montgomery County.

The real estate industry has been put in a crisis situation by high interest rates.

Both the past and present administrations have pursued for almost two years a high interest rate policy which has not worked, but is actually adding billions of dollars a year to the cost of government. This policy has caused countless failures in business. People can no longer invest in homes, automobiles, farm equipment, business, furniture and the necessities of life because of high interest rates.

The future of thousands of Maryland citizens are at stake. Please help.

Very truly yours,

Sharon Taylor
5228 Continental Drive
Rockville, Md. 20853

FRAZEE ASSOCIATES, INC. Realtors

1776 PLAZA, 1776 EAST JEFFERSON STREET
ROCKVILLE, MARYLAND 20852
(301) 881-9000

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Very truly yours,

Geraldine Levitt
7420 Westlake Ter. #1510
Bethesda, Md. 20817

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Very truly yours,

Florence Kernan

11508 Connecticut Avenue
Wheaton, Md. 20902

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Clayton F. [illegible]

Very truly yours,

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Very truly yours,

Marvin H. Taube
11 LANDSEND DRIVE
GAITHERSBURG, MD
20878

FRAZEE ASSOCIATES, INC. *Realtors*

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Very truly yours,

William L Carter
14409 Gunstock Ct
Silver Spring, Md 20906

FRAZEE ASSOCIATES, INC. Realtors

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Very truly yours,

211- Summit Hall Rd.
Gaithersburg, Md 20760
963-1854

FRAZEE ASSOCIATES, INC. *Realtors*

1776 PLAZA, 1776 EAST JEFFERSON STREET
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Very truly yours,

8201-16th St, Apt 118B.
Silver Spring, Maryland 20910

FRAZEE ASSOCIATES, INC. Realtors

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Very truly yours,

Kathryn M. Maglio
610 Valley Brook Drive
Silver Spring, Md 20904

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Very truly yours,

11094 Powder Horn Dr
Potomac, Md 20854

FRAZEE ASSOCIATES, INC. *Realtors*

1776 PLAZA, 1776 EAST JEFFERSON STREET
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Very truly yours,

R L Cardwell

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(301) 881-9000

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Very truly yours,

Marie H. Peck
20233 Laurel Hill Rd.
Germantown, Md 20874

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The future of thousands of Maryland citizens are at stake. Please help.

Very truly yours,

Rosanne Carney
Associate Broker

September 1, 1981

Dear Senator Sarbanes:

I am a resident of Montgomery County and have purchased a home within the past year in Rockville.

From the date of the contract to purchase to the actual settlement date, the interest rate rose substantially but legally I was obligated to settle. I did, even though the monthly mortgage payments at the higher interest rate put a very serious strain on our monthly budget.

I feel the time has come to do something about the high interest rates. It has made owning a home almost impossible.

Very truly yours,

John J Donnelly
4847 Eades St
Rockville Md

September 1, 1981

Dear Senator Sarbanes:

We are registered voters in Montgomery County who find ourselves in an untenable situation regarding the sale of our home.

High interest rates have disqualified a large majority of prospective purchasers.

This situation has forced us, as sellers, into the mortgage banking business. We are doing this under duress, in spite of the risk, because there is no alternative. We fear that we are overextending ourselves and in doing so our future is very insecure.

We implore you, as our representative, to do everything possible to alleviate this situation and make owning a home once again a realistic American Dream.

Sincerely yours,

Laurence A Colburn
Josephine J. Colburn
5105 Oakglen Dr
Rockville Md 20852

September 1, 1981

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Sincerely yours,

Mr. Bachman
1000 Cresthaven Dr.
Silver Spring, Md

11,215 Oakleaf Drive
Silver Spring Md. 2090
September 1, 1981

Honorable Paul Sarbanes
Dirksen Senate Office Bldg 2327
Washington, D.C. 20510

Dear Senator;

Would you please explain to me why I can't buy a home in Maryland (Wash metro area) with my life savings of $19,000, and could cope with an $800.00 monthly payment?

Joyce Knight
(301) 593-9170

Gilbert Hancock Ross,
c/o DeSalvatore Realty
18050 Georgia Ave.
Olney, Md. 20850

September 1, 1981

Senator Paul Sarbanes,

The high interest rates created by the U.S. Government is creating havoc in my family's home life.

I am a Real Estate Broker, Associate Broker with the above company. I work seven days a week, long hours and very little financial gain = This is based on the fact that people can not buy or sell property in todays market.

If the U.S. Government pays 16, 17, + 18% on Treasury Bills, why would an investor lend money at 10, 11, + 12% interest for home buyers??

The solution to me appears to be a ceiling on rates on a national scale. A National Ussery law! 13% tops could be allowed with major tax benefits to investors who earmark their funds for housing.

I would like permission to refer all of my bill collectors to your office. You could have a recording say "Please excuse Gilbert for not paying his bills as he is in Real Estate and is helping our economy control inflation and keep the value of the dollar up overseas!"

See how far that B.S. will go! We in Real Estate are the commission only — no salary industry.

How about giving full time Realtors & Associates emergency loans. We have no unemployment insurance. In fact we don't have anything now! Thank you, Uncle Sam

Sincerely, Gilbert Hancock Jr.

September 1, 1981

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Sincerely yours,

[illegible] E. Fiora
Fannye N. Fiora
12417 Ellen Court
Silver Spring, Md 20904

September 1, 1981

Dear Senator Sarbanes:

We are regestered voters in Montgomery County who find ourselves in an untenable situation regarding the purchase of a home.

High interest rates have placed most homes beyond our reach.

The banking industry's financing alternatives, although making it possible initially to qualify for the purchase of a home, places us in a perilous situation. In subsequent years payments will increase to an unpredictable rate.

As our Senator, we implore you to do everything possible to alleviate this situation and make owning a home once again a realistic American Dream.

Your very truly,

Charles and Marjory Ford
10705 Malone St
Silver Spring, Md. 20902

September 1, 1981

Dear Senator Sarbanes:

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Sincerely yours,

Charles and Marjory Ford
10705 Malone St.
Silver Spring, Md. 20902

September 1, 1981

Senator Paul Sarbanes
U. S. Senate
Washington, D. C.

Dear Senator Sarbanes:

During 1978, after many years of working for some of the quality builders in the Washington Metropolitan area, my partner and I decided we could build a quality home at a reasonable price for the middle income purchaser.

We started with two small lots in an older neighborhood of Silver Spring and successfully built and sold two new houses in the low $70,000 range. In 1979 we purchased 8 lots in the Colesville area, with land acquistion and construction loans tied into prime. Since ours was a small development, the lenders would not make a block of money available for financing these homes.

By doing much of the labor ourselves and offering a superior product we were able to keep our prices below those of surrounding similar new homes and we had sold 7 homes by the Spring of this year. The little profit we might have made was eaten up by the escalating costs of the loans to us. Our remaining finished home, with astronomical interest payments, has been sitting now for several months, not for the want of prospects but because none of the prospects can qualify at today's interest rates. All of the prospects make in excess of $50,000 annually.

Still being optimistic about the future of housing we embarked on the development of 7 more lots in Gaithersburg. These homes should have been ready for occupancy but the present interest rates have made it impossible for us to complete and impossible for home purchasers to qualify for their purchase.

The dream of owning our own business and producing a quality product for Mr. Middle America has been obliterated by the present money market.

Please help,

STONE-OWENS, INC.

Gregory P. Stone
President

Montgomery County Chamber of Commerce
416 HUNGERFORD DRIVE, ROCKVILLE, MARYLAND 20850
PHONE (301) 424-6000

August 31, 1981

The Honorable Paul S. Sarbanes
United States Senator
United States Senate
Washington, D.C. 20510

Re: Hearings of Subcommittee on
Investment, Jobs and Prices
of the Joint Economic Committee

Dear Senator Sarbanes:

Your letter concerning the above-referenced hearings was referred by Barry Scher, President of the Montgomery County Chamber of Commerce, for action by the Montgomery County Chamber of Commerce Legislative Affairs Committee. The Chamber very much appreciates this opportunity to express our concerns about the impact of the current high interest rates on the Montgomery County community.

As we are certain many members of the Montgomery County business and civic communities will express in detail and with some data and examples, it is common knowledge that high interest rates have had increasingly critical impact upon the quality of life and business activity throughout the United States. The concerns are many and reach across the entire spectrum of business activity and civic life. High interest rates impact the business community in many ways; they raise costs of all goods and services for all businesses; they have made the maintenance of satisfactory inventory levels especially difficult; they aggravate cash flow problems for businesses; they act as a disincentive to new investments and expansion in terms of both capital investment and investment in new jobs.

DEDICATED TO PRESERVING COMPETITIVE ENTERPRISE WHILE PROMOTING HUMAN AND COMMUNITY DEVELOPMENT

The Honorable Paul S. Sarbanes
August 31, 1981
Page 2

Perhaps the most obvious and frightening indication of the adverse impact upon business activity of high interest rates are reflected in the decrease in the number of housing starts in the housing industry, the dramatic rise in the number of bankruptcy filings by small and other businesses as well as other individuals, and the decreased number of small businesses which have started during the period of high interest rates.

While the Chamber does not pretend to be able to suggest measures which may be a solution to such a complex problem, nevertheless we feel it is essential to request that Congress and our elected and appointed representatives in government place the highest priority upon efforts to quickly take reasoned and appropriate remedial action to address this situation and eliminate, or at least ameliorate, the adverse impact which the economy has suffered. Should the Montgomery County Chamber of Commerce be able to provide you or members of the Committee Staff with any information or data which may be of assistance to you in your deliberations, please contact us and we will be pleased to cooperate with you to the fullest extent of our capabilities.

Very truly yours,

James W Tavel

James W. Tavel
Chairman, Legislative Affairs
Committee, Montgomery County
Chamber of Commerce

JWT:lm

LONG & FOSTER
REAL ESTATE, INC.

BRANCH OFFICE
11307 GEORGIA AVENUE / WHEATON, MARYLAND 20902
(301) 942-7220

EXECUTIVE OFFICES
3918 PROSPERITY AVENUE
FAIRFAX, VIRGINIA 22031
(703) 573-2282

COMMERCIAL SALES & LEASING
INSURANCE DEPARTMENT
MORTGAGE PROCESSING
PUBLIC RELATIONS & ADVERTISING
RELOCATION DEPARTMENT
RESIDENTIAL PROPERTY MANAGEMENT
TRADE-IN DEPARTMENT

August 31, 1981

Dear Senator Sarbanes:

My purpose in writing is to express concern regarding high interest rates by showing what they are doing to some of the people involved in two of my cases.

Since the VA and FHA programs are designed to help people buy homes please note how they are affecting buyers and sellers in this market of fluctuating rates and points.

On July 12, 1981 I wrote a $66,500 VA contract for a townhouse in Gaithersburg. The purchaser is a Government attorney with an income in excess of $37,000 with a projected increase in October. At the time the VA rate was 15½% and the purchaser easily qualified for automatic approval.

When the rate changed to 16½% his application was sent to VA. His qualifying ratios, job stability, savings pattern and all requirements were excellent. He, with his wife and two small children, must vacate their rented home because the owner is returning to occupy it. On Friday, August 28, the lender was notified that this veteran's application was rejected.

The seller had a prior FHA contract on the same house. When the rate changed to 15½% in May that buyer couldn't qualify. The seller, thinking her house was sold, moved to California.

On July 13, 1981 I wrote a $98,500 FHA contract for a Cape Cod in Kensington. The purchasers are husband and wife, both attorneys, with an income of more than $50,000. They specified in an addendum that they would not pay more than 15½% but did agree to accept 16½% maximum when the rate changed this month.

The seller is a widow who has gotten a construction loan for a retirement home in Florida, based upon the sale of her present home. She gave notice at her place of employment that September 11 will be her last day. In her contract she agreed to pay no more than six points. Her home has a FHA appraisal of $102,000. She will be paying at least $11,300 to settle and she is aware that she may be forced to pay more than six points.

With appreciation for your consideration,

Mary L. Loveless

Mary L. Loveless

REALTOR®

REALTOR®
Lee Frew Platt, Realtors
PHONE: (301) 654-2700
4419 EAST-WEST HIGHWAY, BETHESDA, MARYLAND 20014

September 1, 1981

Faye Cobb, President
Montgomery County Board of Realtors
Kensington, Maryland

Dear Mrs. Cobb:

Enclosed are our collective thoughts relating to sellers and buyers problems in today's residential real estate market.

We ask that you relay our frustrations to Senator Sarbanes on Wednesday, September 2, 1981.

We feel that a comprehensive economic recovery program must be established to ease the burden of millions of homeowners who need to sell and cannot and to help potential buyers achieve homeownership at affordable interest rates.

Sincerely yours,

John Leonard Jr
Yvonne Whitney
Marie D. Heintz
Hsia-Ching Soong
Jane H. Kress

Lee Frew Platt, Realtors

Enclosures

REALTOR FRUSTRATIONS

BUYERS' PROBLEMS

Many would-be buyers, faced with high interest rates and staggering monthly payments cannot, or will not, enter the home buying market today. Multiple new financing programs and fluctuating market conditions generate fear, confusion and uncertainty.

Contributing to the buyers' confusion are the too-many new and untried financing programs, many of which are sponsored by Federal agencies.

Further, because of the total inflation, many buyers (particularly first-time purchasers) have been unable to save even the relatively low proportion of purchase price required for a down payment.

Today's qualified buyer may well be tomorrow's frustrated non-buyer.

REALTOR FRUSTRATIONS

SELLERS' PROBLEMS

Sellers face a great deal of uncertainty and fear in today's market. They know that high interest rates reduce the number of qualified buyers for their property. They are faced, too, with the uncertainty of lenders as to whether their loan may be assumed, at what rate and on what terms.

Many sellers today who are able to sell must drastically discount the value of their property in order to attract a buyer, these discounts coming about through reduced prices, discount fees or a combination of the two.

Then too, a great fear is that with fluctuating market conditions, today's qualified buyer may no longer be qualified on settlement day and that the discounted value may be even lower by settlement date.

Many sellers are forced to move because of job changes, health factors, family situations, etc. Frequently, these sellers not only face the problems already discussed but also are confronted with double payments and/or family separation.

REALTOR®

K AND K REAL ESTATE CO., INC.

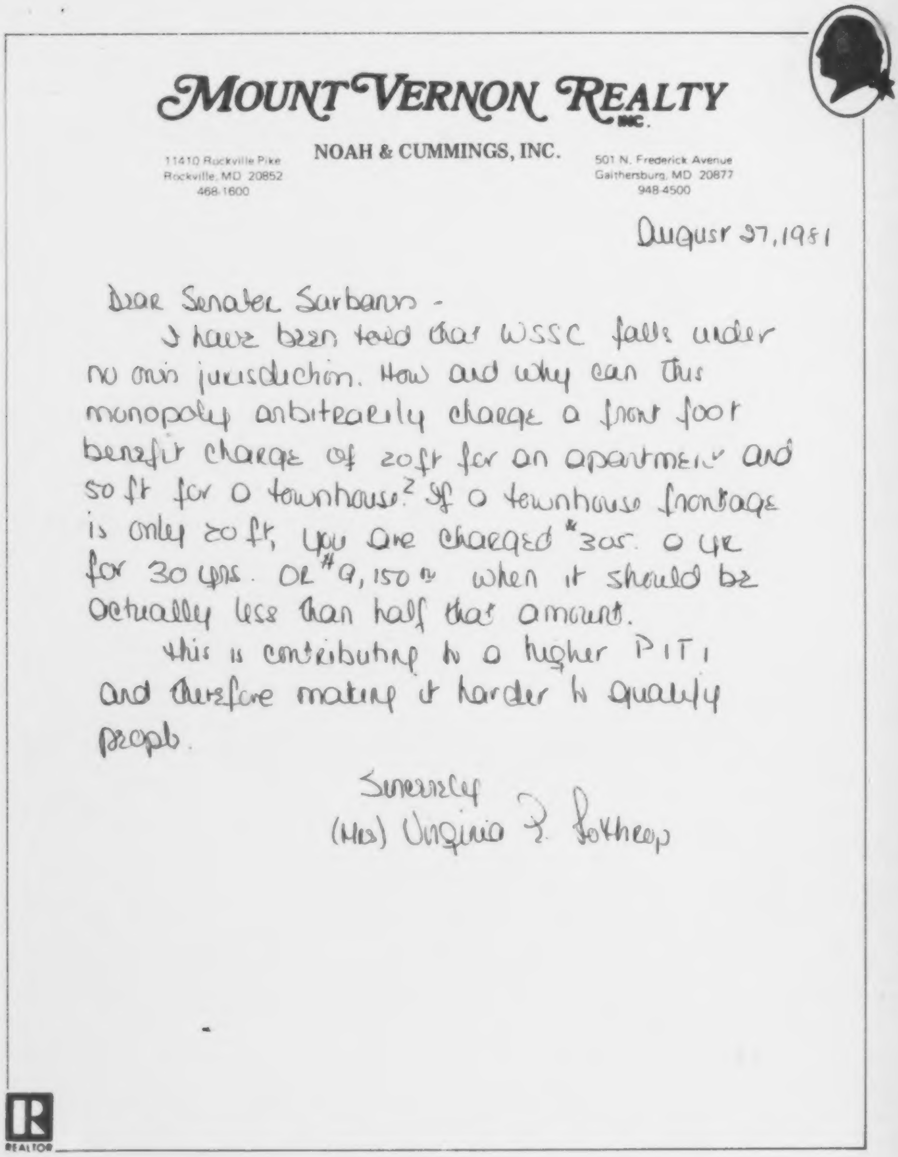
4712 Rosedale Avenue
Bethesda, Maryland 20014
(301) 652-3071

August 28, 1981

Dear Senator Sarbane,

I just want to drop you a note to let you know that the high interest rate is killing my business. I am only a small business man trying to make a living. I hope you can do something in the Congress to help relieve the situation.

Sincerely Yours.
Kuang-Fang Chow



MOUNT VERNON REALTY INC.

NOAH & CUMMINGS, INC.

11410 Rockville Pike
Rockville, MD 20852
468-1600

501 N. Frederick Avenue
Gaithersburg, MD 20877
948-4500

August 27, 1981

Dear Senator Sarbanes -

I have been told that WSSC falls under no one's jurisdiction. How and why can this monopoly arbitrarily charge a front foot benefit charge of 20 ft for an apartment and 50 ft for a townhouse? If a townhouse frontage is only 20 ft, you are charged $305. a yr for 30 yrs. or $9,150.00 when it should be actually less than half that amount.

this is contributing to a higher PITI and therefore making it harder to qualify people.

Sincerely
(Mrs) Virginia P. Lothrop

REALTOR

Senator **Sarbanes**. I want to thank you very much for a very thorough and competent testimony.

Now, we would like to hear from our homebuilders panel. That, I think, follows right along. I think if you can identify yourselves for the reporter, that would be helpful to her; and then we will proceed from there.

Mr. **Barbot**. My name is Charles Barbot. I work for Porten, Sullivan Corp., and am current president of the State of Maryland Institute of Home Builders.

Mr. **Mitchell**. My name is Robert Mitchell. I'm president of C-I/Mitchell & Best Co., a local homebuilders firm, and also president of Suburban Maryland Home Builders Association.

Mr. **Milliner**. My name is Mike Milliner. I'm president of M. S. Milliner Construction, Inc., and president of the Frederick County Home Builders Association.

Mr. **Walker**. My name is John C. Walker. I'm president of John C. Walker Cos., a homebuilder in Montgomery County.

Mr. **Balsamo**. My name is Gary Balsamo. I'm president of Built-Rite Builders, and I'm also a small-volume builder in Montgomery County.

Mr. **Shechtel**. My name is Steven Shechtel. I'm president of Chesapeake Mortgage Corp., and vice president of First Maryland Savings & Loan.

Senator **Sarbanes**. I think we are ready to proceed. Do you have an order worked out amongst yourselves?

TESTIMONY OF N. CHARLES BARBOT, PORTEN, SULLIVAN CORP., ROCKVILLE, MD.

Mr. **Barbot**. Yes. Believe it or not; we do.

Senator, I appreciate the opportunity to speak to you this morning, as spokesman for an over-1,700-member organization representing approximately 30,000 employees throughout the State of Maryland. The task befell me to come up with some sort of Federal innovative policy, if you will, that would suggest that we can have something to do away with these high interest rates that we've currently faced with.

You will hear from the other gentleman, as relates to how that affects their business. I will try to keep my remarks general.

I thought, for several weeks, what kind of innovative thing to come up with, and it was this morning that it finally hit me. It was the thought that you had left with us at our spring board meeting at the NHB, down in Washington, this past spring. It kind of ties in with what Mr. Enfield had said earlier, about where are we going to be 3, 5, 8, 10 years from now.

This is the thought that I would like to leave you with, and I'll leave it with you in the form of a challenge. You had spoken about challenges earlier, challenges for the 1980's. It is for you and your colleagues on Capitol Hill to come up with this secondary monetary system for home mortgage financing that you had addressed to us this past spring.

I don't know what you had in mind. We are not experts in that field, although Steve is an expert because he is in that; but the rest of us are not experts in that field. We don't know what you had in mind, but if it will tend to stabilize—I would think stabilization is a critical thing here—stabilize mortgage interest rates, then you will have our support.

STATEMENT OF ROBERT L. MITCHELL, PRESIDENT, SUBURBAN MARYLAND HOME BUILDERS ASSOCIATION, SILVER SPRING, MD.

Mr. Mitchell. Senator Sarbanes, I'll echo Mr. Barbot's remarks. We appreciate your having the hearing this morning. As I indicated, this morning I represent the housing and building industry members in five counties in Maryland. And I really, sincerely believe that we are doing more than lipservice this morning. We came before you—or you came before us, I guess would be the word, back in the spring, at the time of the budget resolution considerations, and we were quite impressed by the fact that you and Representative Barnes stayed with us all morning and listened to what we had to say. I think your votes over the summer, on the budget and tax issues, indicated to us at least that you had considered all viewpoints.

Your hearing this morning is on the effect of the interest rates. Everybody said the effect is the problem—high interest rates. The real effect—and I'll refer back to this in my remarks for a few moments—is uncertainty. The basic problem we have is uncertainty. It's uncertainty on the part of the buyer; it's uncertainty on the part of the banker or the lender; it's uncertainty on the part of the builder.

This uncertainty has existed for anywhere from 24 to 30 months now, depending upon what part of the country you are in. I would say, here in the Washington metropolitan area and our Maryland counties, we have been in the depths of it for 24 to 26 months, at this time.

Our situation is aggravated by the extreme uncertainty in the banking field. Deregulation of banks and S. & L.'s—and, quite honestly, S. & L.'s have operated from a protected position for years and years, and they just aren't prepared at this time to cope with the changing financial situation. They really don't know what the instrument of the immediate or long-term future is going to be, and as a result, there is almost—using maybe an over-stated word—chaos in the financial, the S. & L., the thrift industry business.

The uncertainty with the buyer—I might make a point. In our communities, when a person comes to buy a house, they are much more worried about what is uncertain than what is certain, because a piece of ground—when I tell them that is zoned for townhouses that will be built in the future, if I tell them that it's zoned for residential single-family houses, they're very concerned about what's going to be built there.

If they come and that site has already been built upon, it's a given and it really doesn't worry them. They are much more concerned about the unknown than the known. So it's the uncertainty.

Now, making a home-buying decision needs—is based on many facts, and if you are uncertain of those facts, as most people are these days, they are not going to make a decision. That's the same in business as it is in buying a house. And right now, the purchaser understands the fact that you have got to pay more for money, to borrow it, than you are going to earn from lending it. However, they don't understand why it is costing so much more.

The average return on savings these days—and I don't have the exact number, but I would guess—is somewhere in the neighborhood of 11 or 12 percent. If you take the amount of money that still is in passbook accounts—either in Federal or State savings or loans—and then you take the amount people have in CD's or money markets, and you average them out, probably 11 or 12 percent is what they're earning.

I don't think that they would feel that it was—I believe they would understand, I should say, 13, 14 percent mortgage rates, because there's a couple of points spread. Years ago, when interest rates—when we were all earning 4.75 or 5 percent on our savings accounts, and mortgage rates were 6, 6.5 percent and they began to go up to 8 and 9 percent, we had the same sort of chaotic situation we have today, structured a little different because of the monetary policy, but we had it.

So, the people are uncertain as to whether the interest rates are going to come back down. They've heard that they're going to come back down. We're going to get back into the situation we had in 1978 and 1979, where, quite honestly, the real estate and building industry were financing inflation. People would buy a new house from me, sell an old house to a realtor. What they would do is borrow more from me than they needed. They would take their cash out of the old house; they would make investments; and it fueled inflation. It just kept churning along.

That situation, quite honestly, should stop. The real estate and building industry should not be supplying the money that causes this galloping inflation—and we were doing it in 1977, 1978, and 1979. It should be brought back into focus.

Now, what has happened as a result of people not making these decisions?

Well, the result is that nationally, there is a demand for over 2 million units a year. Right now, in 1980 and 1981, the first 20 percent of this decade, we are producing nationally—and I am on the national board of directors—approximately 1.2 million units a year. So, at the end of this year, we're going to be about 1.6 million units behind just for this decade, not counting our shortfall in the seventies.

In Montgomery County, there is a proven, documented demand for approximately 7,500 new units per year to meet the needs of our population, our children who are growing up. We are building, over 1980 and 1981, something approaching 3,500 units per year. There was more in 1980; it has become a disaster in 1981. It will probably avarage out to 3,000 or 3,500. So in Montgomery County, after 2 years, we're going to be 9,000 units short.

We all know of people who are doubled up, who are living in quarters—who are not families, but are living together, in order to cope with this lack of housing. The shortfall is really hitting hard at two groups, the under thirties—most occasions I have to speak to people representing the homebuilding industry, I ask how many people in the room are under 30. I won't ask it this morning, but I bet there aren't more than a couple. Those people don't have a chance to represent themselves and tell what their problems are.

They're too busy establishing their careers and their families to know that the housing they need is not being built. It isn't understood.

President Carter had a housing commission that HUD set up, and one of the national builders on that commission stated that, much as has happened in Europe, housing could become the Vietnam—meaning demonstrationwise—of the eighties.

So, the under thirties and then the "empty nesters." We've had a tremendous supply of housing that people cannot sell, and they don't have any alternatives in Montgomery County. They're occupying too much space. They're looking for a viable alternative. We cannot build it under the current conditions. That's partially due to local problems, not just the financial situation we're discussing today.

Now, how do we cope with it, as builders?

Have we gone blindly ahead? I'm proud of the way builders have coped with this situation since 1979. Most of us have cut back in our building volume. We don't build a house now until we have a contract. Our inventory is much lower than it was in the debacle of 1974–75, and most of us have tried to manage as best we could.

However, what has happened now with the sudden surge and uncertainty in interest rates? People are being disqualified so fast that we're building houses we had under contract; people are then unable to go to settlement; and we're holding on to them. I'm budgeting, in my own business, $6,000 to $8,000 in construction financing costs, and I'm averaging $18,000 a unit this year in my construction financing—I'm not talking about permanent financing to the buyer.

So, for 2 years we've managed from a cash flow or survival position. We've bought down rates to understandable levels for the customer. The customers understand 13⅞ percent, but they don't understand 17 percent; it doesn't make sense. So we've had to buy them down. This means, by the time I've paid $18,000 construction loan interest, I buy down a $100,000 loan for a purchaser—that's going to cost me something like $8,000, $9,000, or $10,000—something like that—to buy that down so they can move in the house, and I don't make any money.

Most builders will tell you, I think, all they're trying to do is trying to keep their heads above water. They've been doing it for 2 years. The problem is that we have now gone from a nonprofit to a default position.

If, in fact, these rates at the level they are now are not brought back down to understandable levels, builders are going to—and are right now—going to be foreclosed upon rather than extended.

So, what do we need?

We need, first, a reduction in the Federal regulation of the private economy. Now, I will state—and I'm going to say this is my personal viewpoint; I know it is shared by some builders—that the interest rate that we are now experiencing is orchestrated by the Federal Reserve Board and the presidents of the major banks, in order to create a timing situation for maximum benefit of the administration's economic policy.

If I am right, then relief may not be too far down the road. They may have decided that the timing will be such for the interest rates to come down, so that the administration's economic program can certainly claim benefits. But I'm uncertain as to whether I'm right or not.

So, therefore, what we need right now is that we need the Federal Government and the Congress to send out a clear message to the financial market that it intends to move steadily toward a balanced fiscal situation.

Two, we need a more accurate statement of the consumer price index. The consumer price index is a catch 22 situation which only makes inflation worse. It feeds inflation. It is not—inflation is not running at 9 or 10 percent right now, but yet most people at the end of the year will give their employees a 9 to 10 percent increase in salary, to keep up with inflation; and it feeds upon itself. So we really need quick action to use a more definitive or a more soundly based CPI.

Finally, we need the Federal Reserve and the banks to manage the money supply back down to an understandable stretch. We don't expect mortgage rates to go down to 10 percent, or prime to go down to 8 percent, tomorrow. But right now Chairman Volcker and his group, and the Republican heads of the major banks, are holding them at high levels, and we need that brought down soon, or we're in desperate trouble.

Thank you.

[The prepared statement of Mr. Mitchell follows:]

PREPARED STATEMENT OF ROBERT L. MITCHELL

Good morning and thank you for the opportunity to speak today about the critical issue of continuing high interest rates and their impact on the Nation's housing industry. My name is Robert Mitchell, I am a builder in Potomac, Maryland, and am president of the Suburban Maryland Home Builders Association representing the housing and building industry in these Maryland counties.

You have asked to hear from us about the effect of high interest rates on our business * * *. I can tell you, without exaggeration, that the survival of our industry is threatened by this continuing and seemingly never-ending climb in interest rates and prices that has been taking place since mid-1979—more than two years ago!

Expected declines in interest rates continue to remain elusive. Financial markets are not anticipating sharp increases in Federal borrowing to occur in the fall, and there has been a rapid withdrawal from earlier predictions that both inflation and rates would fall following passage of the Reagan administration's economic program. Now we hear that instead of a downturn we can expect to see rates move to even higher levels.

We simply cannot wait any longer to begin getting interest rates back to reasonable levels, yet we despair of seeing any forceful action at the Federal level to bring this about. Recent statements by Federal Reserve Board Chairman Paul Volcker advised that the Board has decided to further tighten the money supply for the remainder of 1981 and for 1982, thereby insuring that interest rates will stay high for the foreseeable future. Obviously Chairman Volcker is either unaware or unconcerned by the crisis facing the Nation's businesses and industries, the bankruptcies occurring daily, the increasing unemployment as major industry employers as well as small businessmen lay off their idle workers, and the fact that housing starts across the Nation are at record lows.

It is time for the President and the Congress to take a close and serious look at the Federal Reserve Board and its monetary and fiscal policies before we are all "policied" out of business.

Focusing on the situation here in Montgomery County provides evidence that even in this, the most affluent county in the State, record-high interest rates are taking a heavy toll on the local housing industry, with the current rejection ratio on residential mortgages at 50 percent compared to the "normal" level of 10 percent.

Although statistics indicate that the number of building permits, housing starts and housing completions have remained relatively unchanged for this county in

1980 and 1981, this cannot be taken as evidence of a healthy industry. The housing demand in this county, as borne out in the draft of Executive Gilchrist's housing policy, is for an average annual production of 7,760 housing units, and our production of 4,978 units in 1980, and current production of 1240 units in 1981, is falling far short of the need. The burden of high interest rates, more than any other single factor, is keeping us from meeting that need and housing the citizens of Montgomery County.

An examination of specific segments of the market produces an even bleaker picture. In the area of multi-family rentals, building permits for apartment rentals over the past eighteen months totals 1444 against a need of 3725. Again, the cost of money brought about by high interest rates can be singled out as a major offender in impeding multi-family construction. Our elderly, our young couples and new families, as well as newcomers moving into this area from other States, are finding it impossible under the existing interest rates to buy a home or rent an apartment, and the county is facing a critical shortage of adequate, affordable housing at all levels.

Action has to be taken to bring this situation under control. One recommendation—not a new one—would be to reduce the significance of housing and auto costs in the consumer price index. It is misleading, inflation is fueled, and interest rates go even higher * * * thus adding more percentage points to the CPI.

Senator **Sarbanes**. Mr. Walker.

STATEMENT OF JOHN C. WALKER III, JOHN C. WALKER COS., CHEVY CHASE, MD.

Mr. **Walker**. It is difficult for me to speak on behalf of the plight of all the builders and developers, except to say that the current problems among us are far greater than the public and policymakers realize.

I believe that foreclosures and bankruptcy among builders would be rampant if it weren't for the fact that the mortgage bankers and the savings and loan associations are in as much trouble as we are, and are therefore reluctant to blow the whistle. Indeed, many of them are partners with builders, and would only be foreclosing against themselves.

I am the fourth generation in my family to build in the Washington metropolitan area, and hopefully my son, who joined me 2 years ago, will carry on the tradition for a fifth generation, if we survive. Through the years, we have always enjoyed a favorable reputation, both as to the quality of our product and our financial ability. However, if it were not for the cooperation being given to us by our lender, I doubt that we could survive the current crisis.

When we started construction of the first of what is a small group of 12 homes, a little over 2 years ago, the interest rates on the first trusts that were available to us then were 10 percent per annum. Our house was priced at $160,000, and with a 20-percent down payment, the purchasers needed enough income to qualify of $56,700, which was not an unrealistic figure for the type house we had planned and designed for young professionals.

Today, with the market rates at 17 percent plus, at the same price, with the same down payment, the purchasers must earn over $86,000, or an increase of $30,000 in a period of 2 years since we went to market—a 54-percent increase in income to buy the same house, without allowing for any additional price to cover our increase in cost of construction. Our price for this home today is only $10,000 higher, which is an increase of less than 7 percent, during a period in which our costs—that's our basic stick price—increased by 1.8 percent.

To make sales possible, we try to become financial bankers. Reading all the economic reports and being assured that rates were coming down, we made a deal to close loans at 12.5 percent, in order that we could qualify the only purchasers we had available at that time.

In accordance with this agreement, we escrowed with the lender, at the time of settlement, the dollars required to close the difference between the 12.5 percent rate and the then-current market rate. We further agreed to pay monthly the difference between the face rate of the mortgage and one above the prime rate, until such time as the market rate dropped and they were able to sell the loans.

This was done in anticipation that both the market and the prime rates would drop, as was predicted by most of the leading economists. I thought surely, within 1 year, the rate would be back down to 12.5 or 13 percent, the loans would be sold, and I would get back the money that I escrowed.

The facts are quite the contrary. As an example, on one house we closed the loan at 12.5 percent, while the prevailing market rate was 15.25. The loan amount was $127,600 and I placed in escrow $18,884.80. This property was settled in December, and since then I have paid out over $7,500, representing the difference between the 12.5-percent face rate and over prime.

This is a total outlay of over $26,000 to sell a house, excluding closing costs paid by us which were part of the contract, such as sales commission, and our normal construction loan charges. It hurts to sell a house, have someone else live in it and enjoy whatever growth in equity it may have, and still be paying out $1,000 a month, and no way to stop it except to sell the loan—which, at this point, would cost an additional $12,000 in discount.

In other words, my commitment expires in October, and if we sell that loan, I will have paid out $38,000 in less than 1 year, on a loan that was $127,600 to begin with.

Many builders feel the answer to this problem is to buy down the rate to qualified purchasers.

This is a fallacy if the answer is to raise the sales price to cover the discount. As an example, for me to buy the rate down from 17 percent current rate to 14 percent, based on the sale price of $160,000, would cost $19,878.

To buy the house at a 17 percent rate would take, as I've indicated previously, an income of $86,700. If the price is increased by the amount of the discount and the down payment were to remain at 20 percent, to buy, the purchaser would need an additional $4,000, a loan of $16,000 higher, and an income of $82,000 to buy. He has not saved. He saved very little, if anything, when the price is raised.

Although this does qualify the buyer, a slightly lesser income, it requires more money, increases closing costs, increases sales prices—consequently, assessed values and taxes—and in every way and in every aspect is inflation.

To keep the number of points required to buy down the rate, builders and lenders are resorting to 3-year balloons, 5-year balloons, renegotiable rates, and so forth. At best, these might be described as honey on the flypaper. They are only a stopgap; they could lead to the total devastation of the economy.

To bail out in 3 to 5 years from now, we must have inflation in value, substantial increases in income or, look out, we will be back to the years of the Great Depression.

As you may recall, the stock market collapsed in 1929, but the real estate market did not hit the skids until 2 or 3 years later, when the short-term mortgages came due. It was from this environment that the direct-reduction loan developed.

Unless something is done immediately to bring rates down, I fear we will all be part of another Great Depression, and the fifth generation of the Walkers will not survive in the building industry.

Senator **Sarbanes**. Thank you, especially for the very detailed example. I think it's very important to get that into the record, because the significance of the numbers is not fully appreciated. It's helpful to have them spelled out.

Mr. Milliner.

STATEMENT OF MICHAEL S. MILLINER, PRESIDENT, FREDERICK COUNTY HOME BUILDERS ASSOCIATION, FREDERICK, MD.

Mr. **Milliner**. Senator Sarbanes, I'm here to represent the Frederick County Homebuilders Association, which consists of about 200 members, primarily small businessmen employing less than 20 people.

In Frederick, we are seeing what I would consider to be a very serious problem as to the volume of homes being built versus the demand.

We see, back in 1977 and 1978, there were 1,200 permits taken out for single-family homes. In 1979, there were approximately 900. In 1980, there were about 590. And so far this year, there's been about 265 permits taken for single-family homes.

Assuming, as I think is probably safe, that there's not going to be that many more permits taken out for the rest of this year, we are somewhere in the neighborhood of 75 percent off from 3 or 4 years ago.

This is particularly aggravated in Frederick County, where, up until really 3 or 4 years ago, we were primarily a community of small, local builders. Now we have several large national firms; and when you start taking a look at their permit situation, we see where we're 75 percent off from 1978.

And with a relatively meager 265 permits, about three-quarters of those have been taken out by foreign national firms that have recently moved into the Frederick area.

So, that leaves about 56 permits that local builders have taken out versus, potentially, over 1,000 3 or 4 years ago.

The situation is ever worse, because a lot of permits have been taken out, and the houses haven't started because of financing. So, we're looking at probably just about a virtually—a building situation that has just about stopped in Frederick County, other than a very small volume being done by a very few large national firms.

So we end up with a large number of our local people going broke.

A lot of people dropped out of our organization. Our membership is down. We're really struggling to hold onto our membership, to try to keep some continuity.

But we are seeing that the people that are surviving, the small people that have been around for a number of years that are surviving are doing it primarily by small-volume remodeling, which is—in most cases is representing about less than half of what these builders' normal volume is.

What we're finding though is that we had previously a large number of people in Frederick County who did remodeling. Now a lot of builders are going much more into remodeling, and competition gets really tough.

Profits are presently—and have been for some time—practically nonexistent. And as Bob said, the real problem, we're finding, is overhead expenses aren't be covered.

And I think we've already seen the serious impact on a lot of our local builders, and I think it's going to get an awful lot worse if we don't see some relief very soon.

My own personal experience is that I actually increased my overhead back about 6 months ago, anticipating some improvement as I was being lead to be at times. And my main increase was that I put on a full-time estimator and contract negotiator to actually go at and try to get more projects of the few that were available so we could keep our head above water.

Now the interest rates haven't backed off, things haven't come about as they were presumably going to. And about the only thing I have to show for the increase in overhead is a pile of proposals, a number of them sound, but all of them waiting for financing. So I've gone nowhere.

To make matters worse, in my own personal situation also, we built a demonstration and passive solar home through a HUD grant and, I guess in July, we had an open house over a 6-day period, one which we had over 13,000 people come through the house.

We had many, many people who wanted to buy that house, and many, many people who wanted to build a house like it on another lot. But no one thus far has been able to come up with the financing or to qualify for financing.

We, in fact, have an FHA-approved loan for $83,000 because it's a passive solar home, and we just can't find anybody to buy.

So, for me personally and Frederick County, things are getting extremely tight. We don't see any light at the end of the tunnel. In fact, we're beginning to hear about rates getting higher.

As far as what this means to Frederick County in general, instead of just builders and me personally, if you were to assume that 125 homes were to be built in 1 year—which we're beginning to see this year, it's probably going to be less than half of that by local builders—those 125 homes build in Frederick County would represent about $4.9 million worth of materials, purchased primarily from local businesses.

It would mean about 220 workers employed for about a year. It would mean that the average construction worker, who is making in Frederick County, between $16,000 and $20,000 a year, would be putting that money into the local economy. Approximately about

$1.2 million of land development costs would be represented by those 125 homes. And as far as the Frederick County local government goes, it would represent about $99,000 in real estate taxes.

What we're all talking about here though is money and financing, which is important to us, certainly, as businessmen. But there is a social factor which is also very real. That comes from the fact that homeownership is still—I would consider, hopefully, from my end—top on the list of American dreams. When you take that American dream away, you lose, also, the sense of family, the sense of community, and probably, ultimately, the sense of patriotism, which we hope is there in the United States.

The battle cry of the National Association of Home Builders for the past couple of years has been: "Where will our children live?" This seems to be a very appropriate question right now, because we're beginning to really wonder what's going to happen in 5, 15, or 20 years to our children. What are they going to be facing as far as homeownership or shelter, just in very basic terms.

The people in the homebuilding industry are beginning to wonder whether or not we are just literally going to be sacrificed in the fight against inflation and whether the American dream will fall by the wayside. So we are looking for help.

Senator SARBANES. Thank you for a very thoughtful statement.

[The prepared statement of Mr. Milliner follows:]

PREPARED STATEMENT OF MICHAEL S. MILLINER

Gentlemen. My name is Mike Milliner. I am the president of the Frederick County Home Builders Association, which is made up of nearly 200 members. The majority of our membership consists of small businessmen who employ less than 20 people.

You will hear facts and figures during this week's hearings which will show the critical nature of the home building industry. I would like to speak to my area of Maryland and the situation of my members.

Following are examples of a cross section of the comments I have heard in my conversations with various members of the Association.

My first member normally builds 40-plus homes per year and will do about 17 in 1981. His normal payroll of 11 is down to 4.

Our second member usually builds 5 or 6 units and will do 3 this year. His previous payroll of 3 is down to 2. The majority of his present work is in the remodeling field.

Builder member three normally builds 50 to 55 units and will do 20 in 1981. His payroll, which usually ranges from 18 to 22, is down to 9.

Another builder is a large volume custom home specialist who will do less than half his normal volume. By picking up a good deal of commercial work, he has kept all but 7 men.

One of our custom builders reports that he has $630,000 in now-useless contracts on his desk. He is waiting for a drop to even 14-15 percent interest, so that these potential customers can qualify for a loan.

A final check reveals a builder whose entire business formerly consisted a single-family homes, built on contract. He has not had a single order in the last 20 months, and is surviving through the remodeling and refurbishing work he does.

These are the stories of specific members of my Association.

In my case, I build an unusual passive solar home within the past year. This home was built as a demonstration, with Federal funding and with FHA financing available. Recently, during an open house, 13,000 people toured the home. Many people were seriously interested in it but not one could qualify for financing, even under FHA.

We want to build homes.

However, construction loans and interest rates are also expensive for the home builder. Our interest rates are at prime plus 2-4 percent—if you can find a bank to lend you the money. These rates make the purchase of new equipment or improvements to increase productivity prohibitive. Building is difficult now even if there were an abundance of buyers.

But the hopeful buyer who walks into my office finds that FHA/VA loans are at 16½ percent this week. In Frederick County, the FHA/VA loan limit is only $67,500. The buyer also learns that he or she may not be a part of the 11.2 percent of Americans who can now meet minimum loan qualification standards. Back in 1971, for instance, 45 percent of Americans were able to purchase a home.

Have you been in the housing market lately? The average monthly mortgage payment on a $50,000 loan is $692, plus Frederick County taxes of $582 per year. We are talking about an average total monthly payment of $750. Hardly a "starter home" figure.

But the average mortgage amount is $70,000. Our hopeful buyer now learns that the monthly mortgage payment is $969, with $798 in taxes due each year.

At this time, the "rule of thumb" income needed to purchase the $50,000 mortgage is $25,000 per year. Unfortunatly, the median family income in Frederick County is $18,000.

To further research the issue of interest rates, I attempted to learn the effect on Frederick County.

In talking with the county department which issues building permits, I learned that in both 1977 and 1978, nearly 1,200 building permits were issued in Frederick County for single family dwellings. In 1980, 590 building permits were issued, but only 265 permits have been issued to this date in 1981. Over three-fourths of the 265 permits went to four national building firms, who have access to their own financing.

What does this drop mean to Frederick? To better understand housing's vast ripple effect throughout the economy, I looked at what the production of just 125 new single homes means to the local economy.

It costs about $4.9 million for materials and labor to construct 125 homes. About $3.4 million of that amount goes to local lumber, hardware and supply stores to pay for the 2 by 4's, bricks and cement that go into a new home.

Those 125 housing units mean that approximately 220 workers will be employed for a full year in construction, manufacturing and other housing-related industries. Roughly half of those jobs will be filled by carpenters, bricklayers and other skilled and unskilled workers involved in construction and land development.

With skilled construction wages running between $7–8 an hour, a worker could bring home $16,000 per year, not counting overtime, which could bring the total to $20,000 or more. Much of that sum would be pumped right back into the local economy to buy groceries, homes, cars, furniture and other goods and services.

Many of these jobs would go to the unemployed, easing the strain on unemployment rolls, and ultimately, our taxes.

$1.2 million changed hands to pay for the land development and site improvements, such as sewer and water connections, roads, schools, curbs, sidewalks, open space and parks.

Another point to remember is that communities will be collecting real estate taxes from the new homeowners. That comes to about $98,750 a year for 125 homes.

And the new homeowners in the community mean more buyers at local retail stores. These 125 new families will spend a bit over $500,000 for new appliances, furniture, draperies, garden materials and equipment to furnish their new homes.

These figures clearly show that the home building industry and its successes lead not only to a family in their new home, but to far-reaching benefits for the entire community.

That sense of community and roots is lost when a permanent home is not obtainable. I fear that for the first time, a vast majority of American families cannot realize their dream of home ownership until the interest rate climate changes. We must all work toward that change.

Thank you.

Senator SARBANES. Mr. Balsamo.

STATEMENT OF GARY BALSAMO, BUILT-RITE BUILDERS, INC., ROCKVILLE, MD.

Mr. BALSAMO. My name is Gary Balsamo. I'm from Built-Rite Builders. We're a small-volume local builder in Montgomery County.

I've come here today to relate my own experiences since 1979 due to the high interest rates.

No. 1, our firm has had a 60-percent decrease in sales volume. Not being a large builder, a 60-percent reduction brings me down to a virtual standstill.

In 1979, a typical product that we were building sold for $100,000. Today, that same product is selling for $135,000.

And this is not reflecting the fact that, even at the increase in sales prices, what we have done is cover the cost of financing and we are actually operating at a loss at that figure due to a level of increased overhead with less production.

In 1979, in that $100,000 house, we had approximately $6,500 in financing costs. This would be for construction loans and permanent financing. Today, at 17 percent rates, we now have $26,000, or roughly a 300-percent increase in the amount we are appropriating to finance costs.

On that house in 1979, a buyer would require an income of $37,000 and with a monthly payment, at 11 percent, of approximately $900.

Today, the same house requires an income of $69,000 and a $1,700 monthly payment, at 17 percent.

The incomes simply don't exist for the vast majority of potential buyers.

The net effect of today's high interest rates have changed my business from 1979 to now. In 1979, we were planning expansion. Today, uncertainty.

We were production oriented back then, and now we are talking, day to day, about survival.

In 1979, we had job opportunities. Today, we have layoffs.

In 1979, we were operating at a profit. Today, I am operating at a loss, and I won't be able to do that much longer.

In 1979, since we were operating at a profit, we were paying taxes. Obviously, today, we stand to become a burden on the economy if we fail. It's only a matter of time, and a shorter period of time, before we'll be forced out of the building business due to high interest rates.

I don't have the solutions. I do have the desire to produce homes, sell them, and remain a viable element of the homebuilding industry.

Again, if there is not an immediate and substantial decrease in these rates, we just won't continue to operate.

I ask you, as our representative, to take some sort of action with regards to interest rates in order to insure not only my continued existence but the continued existence of the homebuilding industry. Without a viable homebuilding industry, I feel our entire economy is in danger.

And I, too, must ask not only where our children will live in the future but how they will live.

My business is one of producing houses. And in the last couple of years, as the financial situation has changed, I have tried to become well versed in what's going on. I have had to spend a lot of time just trying to figure out what's going on in the financial markets; and hence, I have not had any time—or very little time to spend on the actual production of homes, let alone that there are no buyers for them anyway.

Thank you Senator.

[The prepared statement of Mr. Balsamo follows:]

PREPARED STATEMENT OF GARY BALSAMO

I am a small volume builder in Montgomery County, and I would like to relate to you my experiences since October 1979 due to unprecedented high interest rates. Simply stated, my sales and production volume has decreased to less than 40 percent of pre 1980 levels. I am literally attempting to survive today, and avoid becoming a bankruptcy statistic; and hoping to resume a productive posture to bolster my firm and the american economy.

In 1979 our typical product was a single family dwelling selling for $100,000. Below is a chart explaining why high interest rates have caused a collapse of the home building industry.

	Sales price	Financing costs	Required buyer income	Monthly payment	Interest rate (percent)
1979	$100,000	$6,500	$37,000	$900	11
1981	135,000	26,000	69,000	1,700	17

This increase in sales price does not deflect the fact that at a 1979 sales price, I made a profit; and at the 1981 sales price, I am operating at a loss due to a volume decrease coupled with a level or increase overhead cost.

Incomes required today to buy a new home simply do not exist for the vast majority of potential buyers.

The net effect of todays interest rates have drastically altered my business operation:

1979	1981
Production philosophy	Survival.
Expansion planning	Planning uncertainty.
Job opportunities	Layoffs.
Profitable operation	Operating at a loss.
Paying taxes	Burden on economy due to potential failure.

Sir, it is only a matter of time before I will be forced out of the home building business due to high interest rates. I do not have the solutions. What I do have is a desire to produce homes, and sell them, and remain a viable element in the home building industry today.

If there is not an immediate and substantial decrease in interest rates, my firm and many others will just not survive.

I urge you, as my representative, to take action now with regard to interest rates in order to insure the continued existence of the home building industry. Without a viable home building industry our entire economy is in danger and to that end I must ask you, where will our children live, and how will they live.

Thank you.

Mr. BALSAMO. I would like to have our financial director, Steve Shechtel speak to you about—more specifically about the costs of money and how it's affecting not only my business but the homeowning business in general.

STATEMENT OF STEVEN SHECHTEL, CHESAPEAKE MORTGAGE CORP. AND VICE PRESIDENT, MORTGAGES, FIRST MARYLAND SAVINGS & LOAN, SILVER SPRING, MD.

Mr. SHECHTEL. Senator, one of the things I would like to correct, a lot of people here, unfortunately, have spoken about the cost of money and they have been using 17 percent as a rate. Unfortunately, the builders and realtors are now the front lines as it comes to the good or bad news of interest rates.

I guess I'm the bad guy here today. Last week FHLMC, Federal Home Loan Mortgage Corporation, weighted average yield for home loans was 18⅛ percent to sell a mortgage loan. As of this morning, when I called—which I got the 3 p.m. prices yesterday from the Federal National Mortgage Association—the cost of selling them a conventional home loan for 30-day immediate delivery—and to make that more specific, it means if you don't deliver a loan in 30 days, you've got to send the Federal National Mortgage Association a Treasury bill note in the amount of the amount of money purchased—is now 18.9 percent, which means that home loans at this point have reached the 19-percent level.

So, whoever said it couldn't get much worse, it already has in the matter of a 1-week period of time.

The auctions are taking place today. I do not know what the results will be.

Also, effective last Monday, most of the builders here were able to buy coverage for loans at 1-percent cost. "Coverage" in terminology means they can get a builder—excuse me, a lender to commit to them to buy them out of their construction loans on the completion of the construction of a home for 1 percent of mortgage amount.

Federal National Mortgage Association, effective last Monday raised that rate by 2 percent to buy coverage. We have to pass that cost through. So now there's an additional 1 percent on top of the original 1-percent cost just for us to pay through a quasi-Government agency, the source of funds available to supply housing dollars.

I work with Mr. Balsamo and a number of other small builders because they are the innovators. Mr. Balsamo's firm has won several awards for building an energy-efficient house. He has won awards for being a HOW builder. They've won awards for being innovative designs. These are the type of builders that produce the living environments in the communities that we see.

Two years ago Congressman Barnes spoke at a suburban Maryland homebuilders' dinner regarding high interest rates. I got particularly upset because Congressman Barnes spoke—that we would have to live it out in the trenches and fight the war of inflation through high interest rates. I could tell you I can't last another 2 years; my mortgage company won't last; my savings and loan won't last. And I don't think these builders will last another 2 years of fighting the war.

The cost of end-loan financing for a builder today is prohibitive. I can't see how they can build a home. And I'm the one that has to give them the money for both construction and end-loans. For the particular buy down program, where the builder subsidizes—not even buy down, it's a direct subsidy—the builder is taking the place of the Federal Government in subsidizing that purchaser for a 3-year period of time—runs approximately 11 percent of the mortgage amount.

Currently, today, large builders—when I say "large," I mean national chains—are reportedly paying 14 points, 14 percent of the loan amount, to close the average loan on their home, which means the cost of that home has to be increased by a corresponding amount. Not only does this make the Federal National Mortgage

Association nervous, the Federal Home Loan Mortgage Corporation nervous, but the investing public nervous, those people who front the dollars for these houses, because they know the housing price has got to be artificially increased to offset this difference.

Through the cost of this coverage, such as the 2 points to buy a FLNMA commitment for 4-month delivery, effective October 1, the Government National Mortgage Association, better known as GNMA, which is a subsidiary bank, will start issuing puts and calls on the options market to protect as a hedge against the interest rate fluctuations on government loans, FHA-VA. Those costs are going to be 4 points on top of the cost of discounting that loan for sale. That has got to be passed through.

The standby commitments, where you go to an institutional investor who will issue you a commitment to take the lender out of a commitment that he is issuing to a builder is currently costing 2 percent up front and 2 percent on delivery, for a total of 4 points, not including the origination fees, therefore increasing builders' costs to a minimum cost of 4 percent on the front end, even before he calculates buy down costs and commitment fees in putting together a loan package.

When we add that cost on to the typical commitment of having to make that project conform to end-writing guidelines, as set forth by the Federal Government, those loans must be what they call in the trade warehoused, where I have to go out to the commercial lending institution, borrow the money—just as Mr. Walker has done in his project—at prime or prime-plus, to provide a homeowner with the money so he can make his mortgage payments. That cost is currently running 33 basis points, which is roughly ⅓ of 1 percent per month.

It takes an average of approximately days to sell those loans through, which means I have an additional ⅔ of 1 percent cost on the interest rate on that loan up front, before I can even sell that loan to FNMA, FHLMC, or whomever.

The types of loans being offered the public today are so confusing that the mortgage lenders don't understand them in most parts of the country, and they are even getting the program names mixed up. We have AMR's, AML, VRM's, RRM's FRM's—I can go on all day long. And if you had a bowl of soup in front of you you could probably come up with a program that exists.

To make matters worse, there's a program now called the "bullet loan program," which is a slang term for loans, which is a 3-, 5-, or 7-, or 10-year call provision on the note.

Federal National Mortgage Association, Federal Home Loan Mortgage Corporation announced they're going to attempt to purchase these typse of loans effective January 1.

For a balloon note to be called on a purchaser, with no resulting availability of funds to refinance, three things can happen:

The loan can be foreclosed on, and the lender can take back the property. Not likely. Today, we will not—as a representative from our savings and loan, we are not foreclosing on property due to the fact that we've got so much property right now we can't unload it.

The second thing that's an alternative is renegotiate the terms with the owner. This is not a situation we like, because we've built into our cash flow projection the use of those funds for continued projects.

The third thing that's the alternative is we don't know. The purchaser at that particular point has to go out at a higher cost and obtain another source of funds.

The cafeteria plans of mortgages exist only due to the fact that due to deregulation of the monetary markets and since the Federal Government changed their approach to the fight of inflation on October 6, 1979, programs have cropped up as an answer on a short-term band-aid to the long-term problem that exists.

As soon as rates come under control and are stabilized, these programs will fade away due to the fact that the public will not accept them.

I have a flyer here from the Federal Home Loan Mortgage Corporation that states: "Nationwide, only 26.9 percent of the lenders are offering adjustable mortgage loans. And of that amount, only 10.9 percent are offering them here, in the Northeast United States."

This is a sad commentary from the fact that when the Federal Home Loan Bank Board announces a new program that they feel is a panacea to the lender, yet they can't even offer the program due to the fact of the low acceptance of the public community.

And to make matters worse, we realize, as lenders, that we don't want to own that home 1 year from now, when we're forced to increase that mortgage payment on that purchaser.

I don't like having a borrower sit in front of me, with his wife and kids, looking me square in the eye and saying, "Mister, I can't afford a $200 increase in my payment this year." And that's a low increase, because we're lending in Florida right now—last year, we were lending at 11½ percent on an ARA, and this year we had to up everybody to 17½.

To give you an idea of what the cost is, sir, it's 80 cents per 1,000 per 1 percent. On a 6-percent increase, that's $4.80 per thousand increase on the monthly payment for that home loan.

Why do these programs exist? Of course we talked about it. I don't know. But they also exist to mask their true costs of money.

We talk about balloon loan programs. We are charging the builder, let's say, hypothetically 5 points for the end loan, plus in the rate of somewhere in the neigborhood of 15 or 10 percent. The true cost of that loan skyrockets to the builder and also skyrockets to the homeowner, that makes the average yield somewhere around 19.6 percent. So, they are paying the costs, they are just disguising it.

In construction lending, I sit on the board of directors and the loan committee meetings for my firm, and we are finding almost all the projects that the builders are coming up with, are unfeasible, and we refuse to lend them money.

We will refuse to lend them money because of one, the end-loan commitments we have to not buildin 14 points to the average price of a home.

Two, we require that the builder sell his model home to a group of investors, so that he is not forced to carry the cost of that home.

The third is the warehousing cost that we have to buildin, and also the carrying costs regardless of the construction loan.

All of our commitments currently state that the lender—excuse me—the builder cannot be allowed to build in excess of two homes that is unsold. This means that if a builder wants to offer four model homes, he has to choose which two will be his most profitable that he can put up and sell on a model home speculative basis.

This not only discourages the builder from productivity, but it also makes very risky for him to build, due to the fact that a purchaser may try to buy a home and then decide he doesn't like it and then force his way to back out of the contract.

We are currently financing end loans on projects that the Federal Government, through a HUD plan, supplied the construction loan in the District of Columbia.

The Federal Government is also subsidizing the home purchases due to the fact that they are minority candidates.

To make it sound even funnier, I cannot close the loan for HUD because the purchaser won't qualify because the amount that the Government is subsidizing the purchaser is insufficient to cover the guy's down payment.

So I have a Government loan with zero interest on a Government piece of property, with Government-subsidized purchasers that I cannot settle a loan on because the Government has an interest rate in excess of what they can buydown the rate to on their own purchasers.

It is really sickening.

The volatility of interest rates has made building a home in the marketplace nothing more than rolling crap as in Atlantic City.

The FHA/VA interest rates, you will notice on the chart in my prepared statement that I supplied to you, was adjusted in 1980 eight times. In 1981, since April 10, we have seen three rate changes. That rate, since the beginning of 1981, on March 11, went from 14 percent to 16.5 percent. And currently, this morning, Senator, the price of money is running at 9 points, and we expect an additional rate increase on FHA/VA loans of Government-backed loans to around 17–17.5 percent.

Unless the Federal Government does something to shore up the secondary mortgage markets in this country, and to give some security and comfort to the lending public or Wall Street, the collapse of the secondary market is indeed prevalent. We are witnessing it right now through the lack of availability of mortgages in the mortgage money market, and these builders and realtors, no matter what they try to do in any type of creative program will be pushed out of business entirely, due to the fact that there will be no source available at any price for their home loans. And that is happening currently today.

Thank you very much, Senator.

Senator SARBANES. Thank you. You have been a very good, very thorough, and very detailed panel and I want to thank you for the obvious effort and preparation that went into this testimony. I think you have put into the record—and I think it is important to do so—some very important statements backed up by some very detailed examples.

Thank you all very much.

[The prepared statement of Mr. Shechtel, together with graphs, follows:]

PREPARED STATEMENT OF STEPHEN SHECHTEL

I Current Market Conditions:
- A. Conventional rates
    - 1. FNMA 19.1%
    - 2. FHLMC 18 3/4%

II Action Needed Now:
- A. Congressman Barnes stated two years ago, the war on inflation must be fought by the public
- B. Bankruptcy is not the answer. Losses are at an all time high.
- C. We cannot last another year of high rates.

III End Loan Financing Costs:
- A. To Builder/loan per house
    - 1. Buydowns 6.75% points per 1% reduction in rate.
    - 2. Direct Subsidy
    - 3. Hedging interest rate - risk costs
        - 1. FNMA now increased commitment fees to 2%
        - 2. CBOT GNMA call option 4%
        - 3. Standby commitments 2% up front; 2% upon delivery of loans. Total 4%
        - 4. Short term borrowing costs 1/2% per month.
- B. Loan Types and Programs
    - 1. ARMs
    - 2. AMLs
    - 3. VRMs
    - 4. RRMs
    - 5. FRMs
    - 6. Balloon notes
    - 7. GPMs
    - 8. PAMs
    - 9. SAMs
- C. Effect on market on new loan programs
    - 1. Very risky for borrower
    - 2. Foreclosure risk increased significantly
    - 3. Causes further confusion on part of public
    - 4. Investors become leary of changes to instruments traditionally used.
- D. Personal Implications
    - 1. Disposable income to cover housing over 50%
    - 2. Foreclosure worries
    - 3. Interest rate risk not under control of Borrower. Rates [illegible] then incomes.

IV Why Programs Exist
  A. Lenders unsure of economy
  B. Volatility of rates caused by Fed.
  C. Disguises true cost of money
  D. Shift interest rate risk to Public

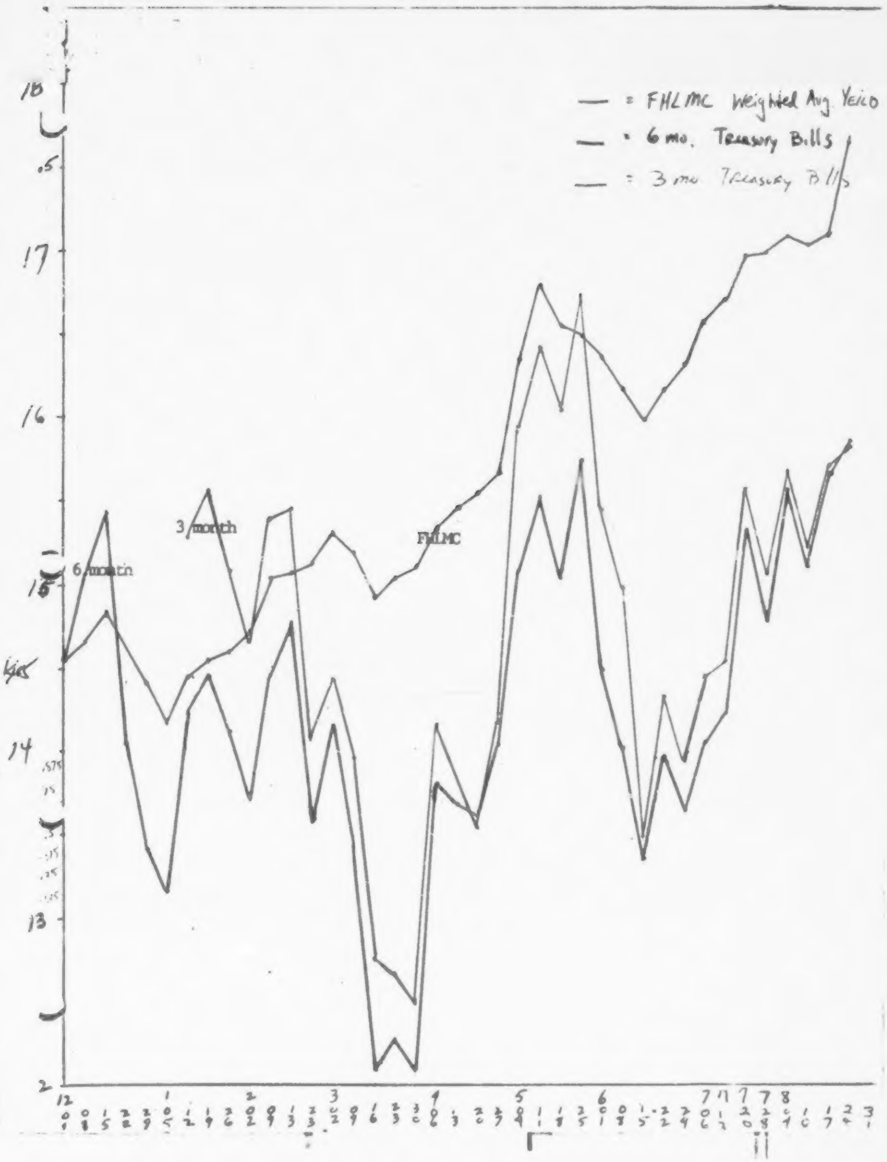
V Examples of current problem
  A. DC Housing project
    1. Government subsidized borrowers
    2. Government funded construction loan
    3. Government supplied buyers down payments
    4. Purchasers do not qualify even with government subsidized buydown.
    5. Therefore, project sits unsold.

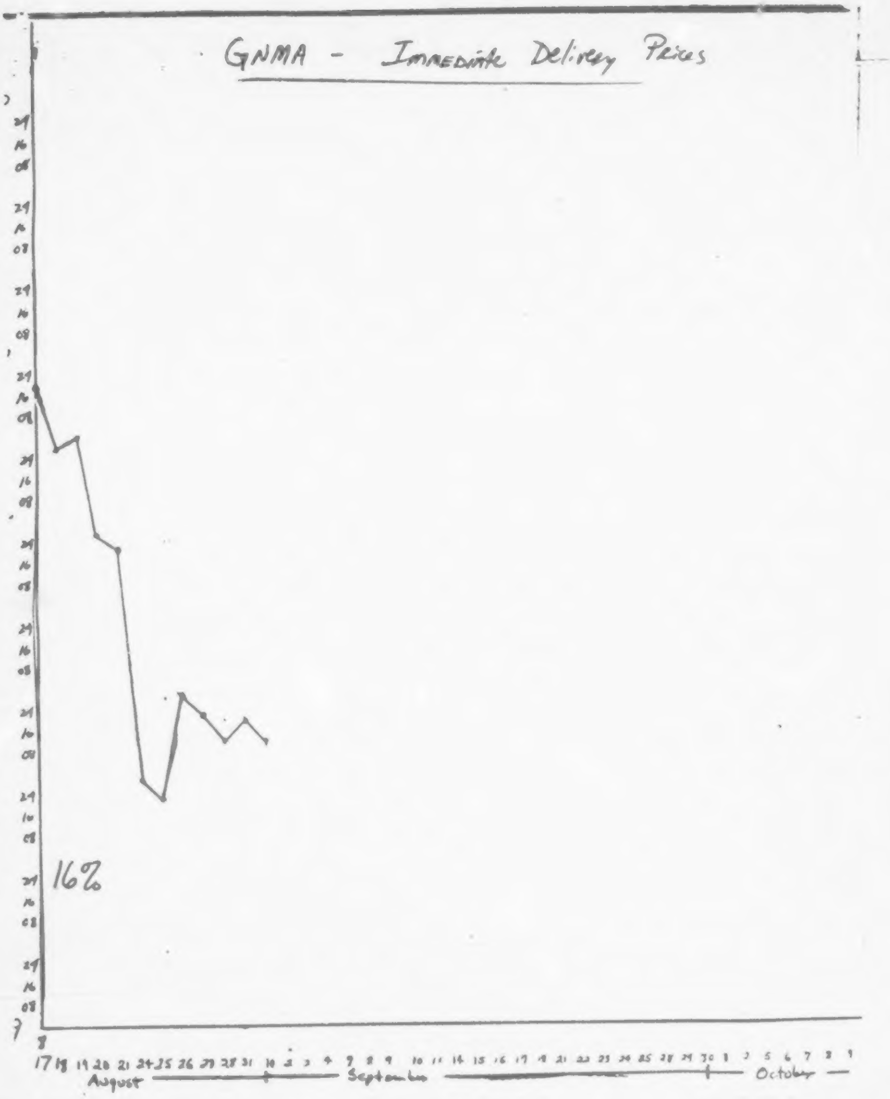
VI CONSTRUCTION LENDING
  A. Most projects provoing to be unfeasible
    1. End loans too expensive (12 - 14 points)
    2. Construction loans too expensive (2+ points)
    3. Construction interest too high at 21%
  B. Spec. Housing cannot be built -
    1. Cost too high to carry

VII RATE VOLULITY
  A. See graphs
  B. FHA/VA 13 rate changes in 21 months (once every six weeks)
  C. Purchaser could buy home and while loan is in process and house is being built, they get knocked out of qualifying.

VIII COLLAPSE OF SECONDARY
  A. FNMA "out" of market at 19% and 2 points
  B. FHLMC "out" of market at 18 3/4%
  C. Savings and Loans drained; therefore, no commitments being issued.

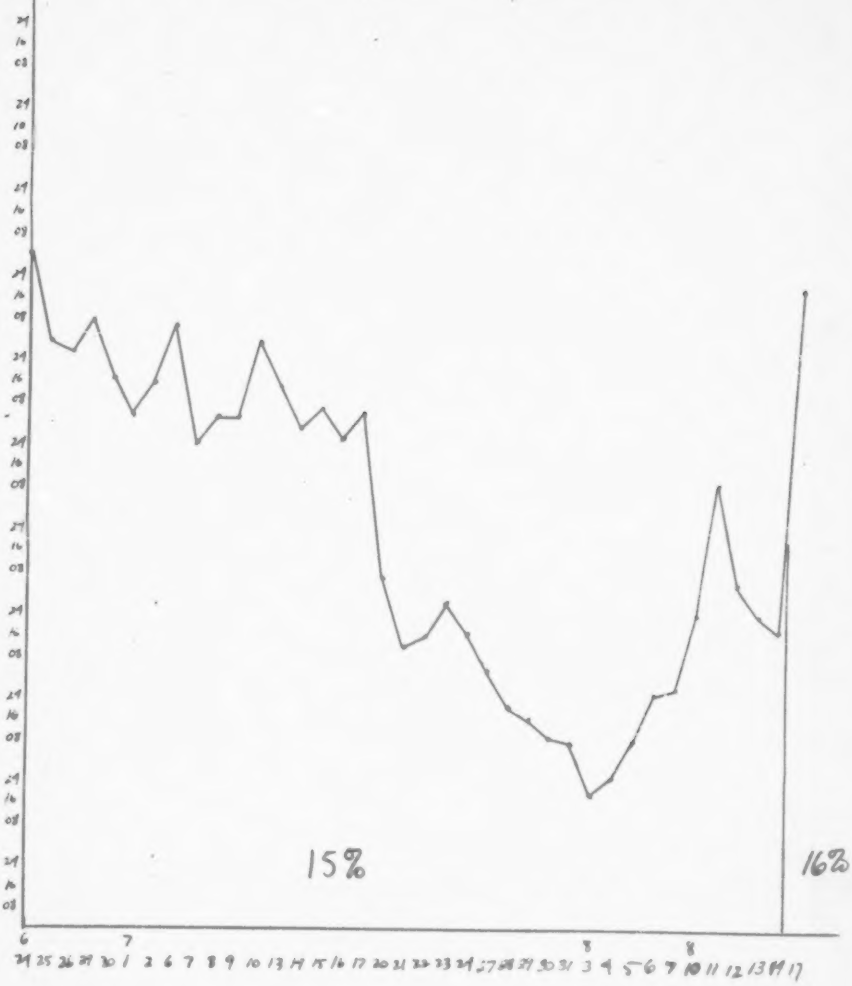
IX FORECLOSURES
  A. Would be higher if lenders were not carrying Borrowing Builders.

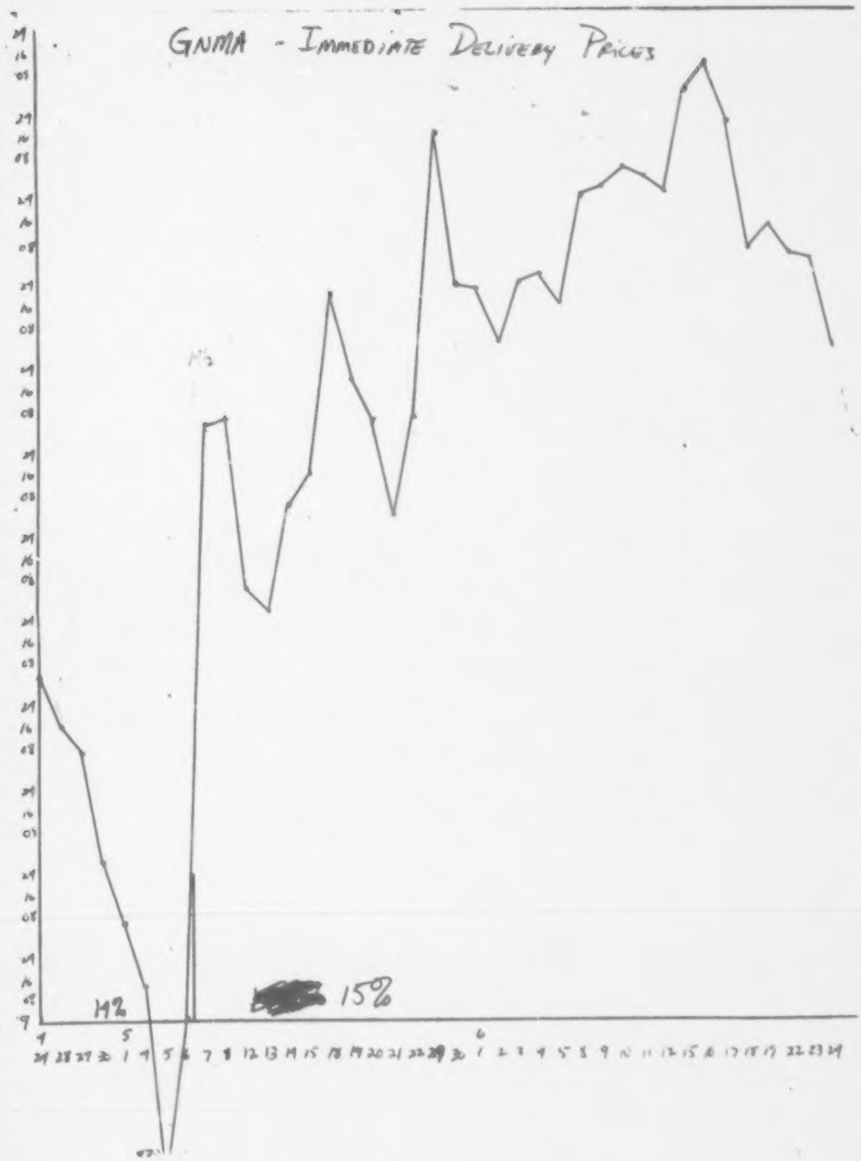

— = FHLMC Weighted Avg. Yield
— = 6 mo. Treasury Bills
— = 3 mo. Treasury Bills
18
.5
17
16
15
14.5
14
13
2
6 month
3 month
FHLMC
12
1
2
3
4
5
6
7
8

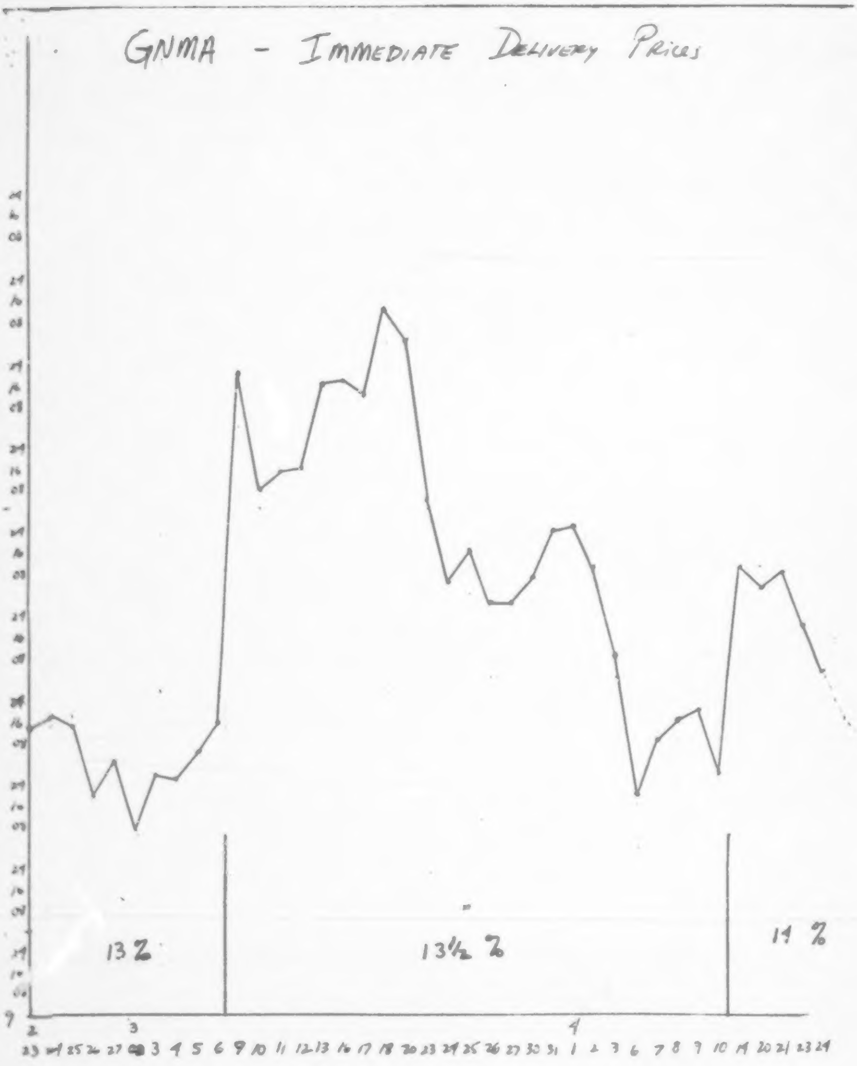


GNMA - Immediate Delivery Prices

GNMA - Immediate Delivery Prices




GNMA - IMMEDIATE DELIVERY PRICES
24
16
08
14½
14½
[redacted] 15%
4
5
6
24 28 27 30 1 4 5 6 7 8 12 13 14 15 18 19 20 21 22 29 30 1 2 3 4 5 8 9 10 11 12 15 16 17 18 19 22 23 24


GNMA - IMMEDIATE DELIVERY PRICES
13 %
13½ %
14 %
24
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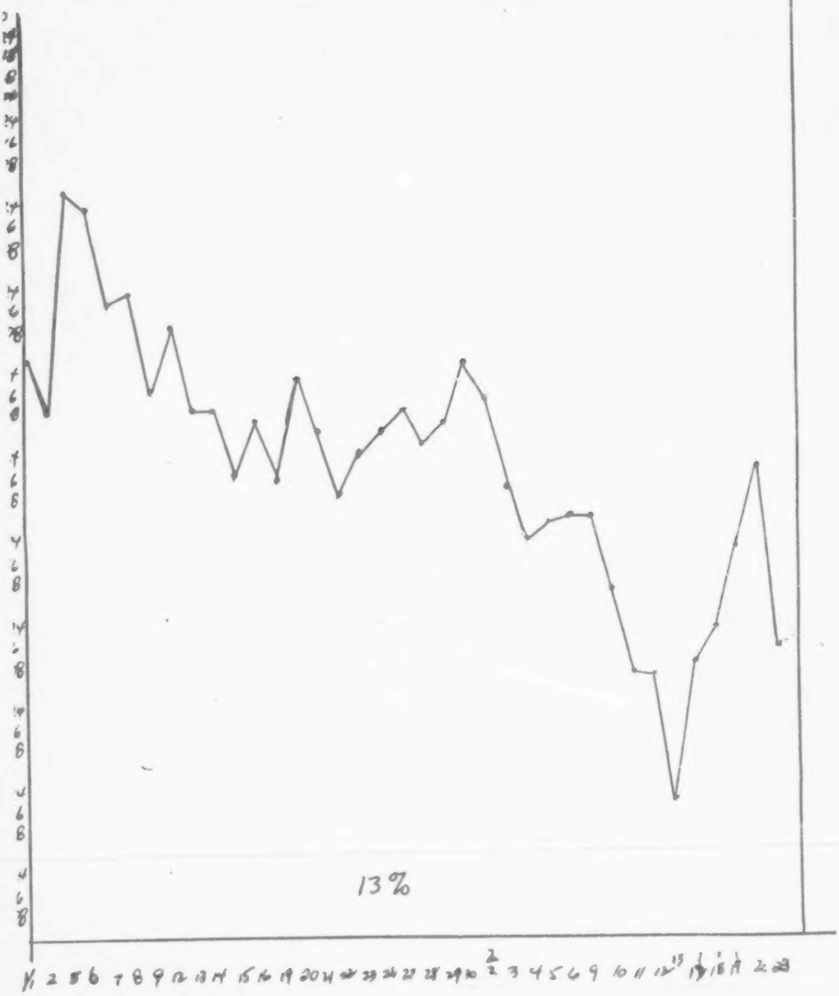
23 24 25 26 27 [illegible] 3 4 5 6 9 10 11 12 13 16 17 18 20 23 24 25 26 27 30 31 1 2 3 6 7 8 9 10 14 20 21 23 24

GNMA - IMMEDIATE DELIVERY PRICES



D. HISTORY OF MAXIMUM FHA AND VA LOAN INTEREST RATES

FHA-INSURED LOANS		VA-GUARANTEED LOANS	
Rate	Effective Date	Rate	Effective Date
5.00%/5.50%[1]	11/27/34		
5.00%	6/24/35		
4.50%	3/1/39		
		4.00%	6/6/44
4.25%	4/24/50		
4.50%	5/2/53	4.50%	5/5/53
5.00%	12/3/56		
5.25%	8/5/57		
		4.75%	4/4/58
		5.25%	7/2/59
5.75%	9/23/59		
5.50%	2/2/61		
5.25%	5/29/61		
5.50%	2/7/66	5.50%	3/3/66
5.75%	4/11/66	5.75%	4/12/66
6.00%	10/3/66	6.00%	10/4/66
6.75%	5/7/68	6.75%	5/7/68
7.50%	1/24/69	7.50%	1/25/69
8.50%	1/5/70	8.50%	1/5/70
8.00%	12/2/70	8.00%	12/2/70
7.50%	1/13/71	7.50%	1/13/71
7.00%	2/18/71	7.00%	2/18/71
None[2]	7/1/73	6.00%	7/1/73
7.75%	8/10/73	7.75%	7/26/73
8.50%	8/25/73	Same as FHA	
8.25%	1/22/74		
8.50%	4/15/74		
8.75%	5/13/74		
9.00%	7/8/74		
9.50%	8/14/74		
9.00%	11/25/74		
8.50%	1/21/75		
8.00%	3/3/75		
8.50%	4/28/75		
9.00%	9/2/75		
8.75%	1/5/76		
8.50%	3/30/76		
8.00%	10/18/76		
8.50%	5/31/77		
8.75%	2/28/78		
9.00%	5/23/78		
9.50%	6/29/78		
10.00%	4/23/79		
10.50%	9/26/79		
11.50%	10/26/79		
12.00	2/11/80		
13.00	2/28/80		
14.00	4/3/80		
13.00	4/28/80		
11.50	5/15/80		
12.00	8/20/80		
13.00	9/22/80		
13.50	11/24/80		
14.00	3/11/81		
14.50	4/10/81		
15.50	5/7/81		
16.50	8/17/81		
17.50	9/14/81		

NOTES: [1] 5% for acquisition; 5-1/2% for refinance of existing mortgage indebtedness or creation of mortgage indebtedness on property constructed prior to June 7, 1934

[2] FHA authority lapsed June 30, 1973; renewed by Congress effective August 10, 1973

Senator **Sarbanes**. Mr. Morris, Ms. Hillstrom, and Steve Abrams. Why don't you all come up now.

If you will summarize your statements, we will include them in full in the record.

TESTIMONY OF HELEN HILLSTROM, HILLSTROM REAL ESTATE, ROCKVILLE, MD.

Ms. **Hillstrom**. Senator Sarbanes, I am here on behalf of the Rockville Chamber of Commerce who was invited by your office.

My statement will be brief and rather general, because many of the previous speakers have said pretty much what I would have to say.

I do want to say that we businessmen and women who make up the Rockville Chamber of Commerce are very proud to be part of Rockville. Our area has been a good environment for business, there has been a lot of growth and we expect a lot of growth in the future.

Our chamber members represent the typical professions and businesses found in most metropolitan areas. We have a large number of builders, bankers, and developers; real estate brokers, retailers offering a wide range of goods, restauranteurs, service companies, auto dealers, lawyers, accountants, and so forth.

As you can see, many of our members are involved in the types of businesses that are most adversely affected by the effects of high interest rates.

Whereas, as a business community, we have been looking forward to any attempt at a reponsible fiscal policy to control inflation and strengthen the economic health of our society, the result of prolonged high interest rates are hurting us.

It is well known in general that bankruptcies have substantially increased, that delinquencies are up substantially, that the business volume in terms of borrowing is way down.

Our business people are trying to outlast this difficult period. It has been a long period, and experts do not agree as to when it will end.

Relief is needed, and it is needed now to keep more businesses from going under.

We want our Rockville community to survive and be vital in the business community.

We don't know how you spell relief, Senator Sarbanes, but we need it soon. We would hope that any relief that is created, any program that is developed, will be coordinated with the long-term goals of our society, to stabilize our economy. Otherwise, we will be repeating this again in a few years.

Senator **Sarbanes**. That's a very important point.

Ms. **Hillstrom**. The Rockville Chamber of Commerce thanks you for inviting us here, and we will be looking forward to hearing the results of this investigation.

Senator **Sarbanes**. We are pleased to have your testimony. I know the strength of the chamber, and how effective you have been here.

I think your last point is a good one. We really need to get on a course that is balanced, one that we can follow instead of gyrating back and forth. I think that is absolutely correct.

Mr. Morris.

TESTIMONY OF HAROLD MORRIS, PRESIDENT, HERITAGE BUILDERS, GAITHERSBURG, MD.

Mr. **Morris**. I am Harold Morris, I am here on behalf of the chamber of commerce as a small businessman. I am not particularly enthused about being a spokesman as a small businessman, and I will tell you why.

Three years ago I was chairman of a local bank that was making loans to small business communities. We had high hopes and aspirations. We were growing, our base was growing, our depositors, and our loans.

Our depositor relationship stopped growing in bulk over the past 3 years and we have seen various things happen to the loans that we made.

In the past year I have officiated at probably 30 funerals of businesses who had closed because of the high interest rates. In checking the records, there were probably 70 others who are now critically ill, terminal cases, different categories, that undoubtedly under the present course of action, present interest rates, will pass away.

This is unfortunate.

Last week, I was also the chairman of the board of a small bank. This week, I'm not. The bank merged with a larger one Monday. So I am out of that job.

I have been a self-employed businessman, a builder, since 1954. For the past 15 years, I guess, up until 3 years ago I have been building on average, between 50 and 100 dwelling units per year. I was quite comfortable with this size and no aspirations to get any bigger.

This year, I built one house. I still have that house. I can go out of business, but I have sons who are in the business. We are doing other things—we built for ourselves, we have been building some commercial things.

I am delighted to be here today. I might be representing a category 6 months from now that isn't even noted here, and that would be out-of-business. I really don't know.

I do feel if the people who are responsible for our problems had faces and names, instead of numbers and percentages, I think something could be done and would be done, because I think it is within the power of the Government to do it. But, I frankly believe from both my categories of work, if you will, that the Government is primarily responsible, due to their borrowing decisions, of creating the problem.

Senator **Sarbanes**. Thank you.

Mr. Abrams, please proceed.

STATEMENT OF STEPHEN ABRAMS, MEMBER, ROCKVILLE CITY COUNCIL, ROCKVILLE, MD., ACCOMPANIED BY JOHN LAWTON, DIRECTOR OF FINANCE

Mr. **Abrams**. Thank you Senator Sarbanes. For the record, my name is Steve Abrams, and I am a member of the Rockville City Council. I am accompanied by John Lawton, our finance director.

Earlier witnesses have provided vivid examples of the impacts of the high costs of borrowing on small business, financial institutions, homebuilders, buyers, and owners.

Rockville has a concern about high interest rates, too. Our concern is in the area of municipal borrowing. And, although we don't face the immediate prospect of losing our business, or having our facilities foreclosed, the problems of high interest rates have an equally insidious impact on the city. When our rates go up, everybody pays for it.

I have an example in my statement, and I will ask that that be reviewed. It details what is happening in a year's time, when we went out and what we felt was an outrageous rate of over 7 percent last year, we are now facing with a $12 million bond issue, the prospect of rates nearly double that amount.

The costs associated with that, as they impact on the taxpayer, are rather significant.

We are lucky in Rockville, because we have got a sound financial basis in that we can make some deferral of decisionmaking and use some financing options because of our position, so that we can hopefully weather the storm and move into the bond market when it is a little more favorable to us.

But, we can only do that so long. And what really troubles me, and what I wanted to reflect in the record today is that municipalities that aren't in as favorable position as Rockville, don't have that option. They are being compelled to resort to gimmicks, and those gimmicks are part of the problem.

You have heard a lot of conversation made about creative financing. From the municipal standpoint, we are finding that the problem is on that is very, very frustrating because we have no control over it. Forces outside of us are really what are promoting these high interest rates. The best that we can do is exercise restraint on local spending, or pursue strictly pay-as-you-go financing policy.

The problems of high interest rates are national problems and the Government solutions, if they exist, rest on our Federal tax and spending decisions. Let me give you a few examples as they impact municipal borrowers.

When the Federal Government continues to preempt the pool of money available for borrowing in order to satisfy its debt service needs, municipal bond rates go up.

When new forms of tax-exempt instruments are introduced to address areas previously financed by taxable instruments, we suffer because it makes it more competitive for our needs.

More insidiously, when the tax-exempt status of institutions now allows them to go out and make choices to go out and acquire taxable bonds because of their tax deferral or nontaxable status, then it takes away from us a market that legitimately existed for municipal bonds. And the consequence is, our rates go up higher.

I am not questioning any of the policies that led to the choices that were made, but if we really want to combat interest rates from a governmental standpoint, I think the time has come to reexamine the purpose behind all of these approaches that we have taken.

Now, I am speaking from municipal concern. We were given a favorable treatement of our borrowing instruments, precisely to address and allow us to compete on a different level using the tax laws offensively.

We lost that, When McDonalds can go out and be financed using industrial development bonds at a tax-free rate, it is merely another way of saying that they are being subsidized by the Government. They are being subsidized in two ways; they are being subsidized by the reduced rates, and they are being subsidized by us to the extent that our borrowing costs go up.

This has got to be changed. And I think if there is one message I would like you to take back to town when you go back into Washington, it is to reexamine this in the context of the changing tax and spending patterns. The new tax bill, and the impacts of the new tax bill really aren't a reflection on current economic problems we are having with interest. The gestation period has been over the course of the last decade, nad we are only now seeing with the ballooning is growing from month to month, of the policies that we have been pursuing.

I think that it is appropriate that we take a look at the new taxing policies and see where they have to be further finetuned to place the kind of emphasis back on giving the secondary market favorable to them, using those tax laws as they have been used before.

Thank you.

[The prepared statement of Mr. Abrams, with an attachment, follows:]

Prepared Statement of Stephen Abrams

Thank your Senator Sarbanes. I appreciate this opportunity to appear before the subcommittee on investment, jobs and prices of the Joint Economic Committee.

For the record, my name is Steve Abrams and I am a member of the Rockville City Council. Accompanying me is John Lawton, Rockville's director of finance.

The purpose of this hearing, if I may borrow the Senator's words, is to "examine the effects of continuing, unprecedented high interest rates on Maryland communities." I am sure other witnesses will provide vivid examples of the impacts of the high cost of borrowing in small businesses, financial institutions, homebuilders as well as present and prospective homeowners. Rockville has its own concerns about high interest rates; our concerns focus on the impact on municipal borrowing. And although we as a city do not face the immediate prospect of losing our "business" or having our city facilities subject to foreclosure, the impact of our higher cost of borrowing is equally insidious. For when it costs the city more to borrow, it is the public that ultimately pays.

Let me give you an example. Early in 1980 the city needed to borrow $3.5 million to finance a number of general improvement projects, including streets, sidewalks, and water and sewer projects. A sale was scheduled for late March. In the late March-early April time period, interest rates rose dramatically, with the bond-buyer index reaching the dizzying (at the time) height of 9.44 percent. The bond sale was cancelled and a sale of short-term notes was scheduled in its place. The market began to improve in the late spring, so the note sale was cancelled and the bond sale rescheduled. The bonds were sold in late June with an interest cost of 7.12 percent. At the time, just over one year ago, we were somewhat disappointed because we were hoping to pay less than 7 percent.

The city has an additional need to borrow $12 million to finance our capital improvements program. Included are a number of vital transportation projects such as the reconstruction of North Washington Street, Gude Drive, and other roadway improvements in various parts of the town center. We have an immediate need to borrow, but it will be impossible to issue long term bonds with the bond buyer index now up to 12.49 percent. By comparison, the 1980 rates appear quite reasonable. If the city had to issue bonds at today's rates, the additional cost, beyond what it would have cost just a year ago, over the life of the bonds, would be over $5 million. For each $1 million the city borrows, one additional interest rate point costs over $100,000.

The city will be considering alternative methods of financing, particularly short-term notes which would be replaced by long-term bonds at a later time. In any case, the end result will be higher interest costs to pay for short-term financing and higher administrative costs to pay for additional preparation.

We in Rockville are lucky. Because of our strong financial condition, we can weather this high interest storm. However, if our discomfort, occasioned by these higher interest rates, is causing this much of an adjustment for a municipality as financing sound as Rockville, we can only imagine the impact it is having on less financially sound communities. Rockville does not need to resort to financing gimmicks which offer present benefits at the expense of future long-term financial commitments. However, other communities may not be as fortunate. And therein lies part of the problem.

What is frustrating to me is that as a city official I am powerless to initiate any solutions on the local level. The best I can do is exercise restraint on local spending or pursue strictly "pay as you go" financial policies.

The problem of high interest rates is a national one and the governmental solutions, if any, rest in our federal tax and spending decisions. Federal policies have created demands for borrowing that adversely affect sound municipal borrowing. For example:

When the Federal Government continues to preempt the pool of money available for borrowing in order to satisfy its debt service needs, municipal bond rates go up;

When new forms of tax-exempt instruments are introduced to address areas previously financed by taxable instruments, rates on municipal bonds go up;

When tax-exempt status is expanded to allow pension funds and other institutions to find high yielding corporate bonds more attractive, our municipal bonds lose natural markets and, consequently, our rates go up.

I am not questioning that valid public policy considerations may have independently justified the special tax status afforded new instruments or institutions. Nor am I questioning the intent of our previous federal spending policies. What I am simply stating is that the current crisis stemming from the high cost of borrowing has resulted in significant part from these types of actions and will only be corrected by readdressing our Federal approach to borrowing and tax expenditures.

As a city official, I, too, am concerned about the plight of our local small business community, our financial institutions, homebuilders, buyers and owners. However, I am equally concerned about the municipal impact of the high cost of borrowing. When it costs the city more to borrow, you hear less about it. But when it costs us more, everybody pays.

This concludes my prepared remarks. I would be happy to respond to any questions.

Attachment.

U.S.NEWS
& WORLD REPORT

Sky-High Interest Rates

Borrowed funds—the lifeblood of the economy—are getting far too expensive for business, consumers and government. Result: Chaos in the marketplace.

The spreading pain of surging interest rates is threatening to hobble the nation's economy and even drive it into a new recession.

Amid rekindled fears of double-digit inflation and higher budget deficits, the near-record borrowing charges are exacting their toll on business, consumers and revenue-hungry governments alike.

Jittery financial markets reacted in late August as stock and bond prices went into steep slides, causing tens of billions of dollars in paper losses. Companies and municipalities withdrew bond offerings rather than pay the stiff interest rates demanded.

The severe construction squeeze showed no sign of easing as yield-conscious depositors withdrew huge amounts of money from thrift institutions—the primary source for building loans and consumer mortgages.

Auto companies resorted to rebates and interest-rate discounts to lure customers and clear out unsold vehicles.

Farmers fell further behind on their loan payments, and thousands of businesses—large and small—shelved expansion plans and trimmed inventories. Others shut their doors as business failures soared.

Said Jim Goodwin, owner of the J&J Grocery in Rushsylvania, Ohio: "I'm for Reagan and like what he's doing. I just hope I can hang on long enough to benefit from it."

Sky-high interest rates were creating so much havoc that President Reagan summoned advisers to his vacation ranch in California to search for ways to cut federal spending even further and reduce pressure on money markets.

Not even defense outlays are to be exempt, Defense Secretary Caspar Weinberger discovered after an August 26 meeting with the President and Budget Director David Stockman.

The White House fear: Sharply higher borrowing costs could unravel the Reagan plan to revive the economy—even before it is implemented.

Said the President: "They are hurting us as much as they are hurting everyone else—those interest rates. We think they will be coming down before the first of the year."

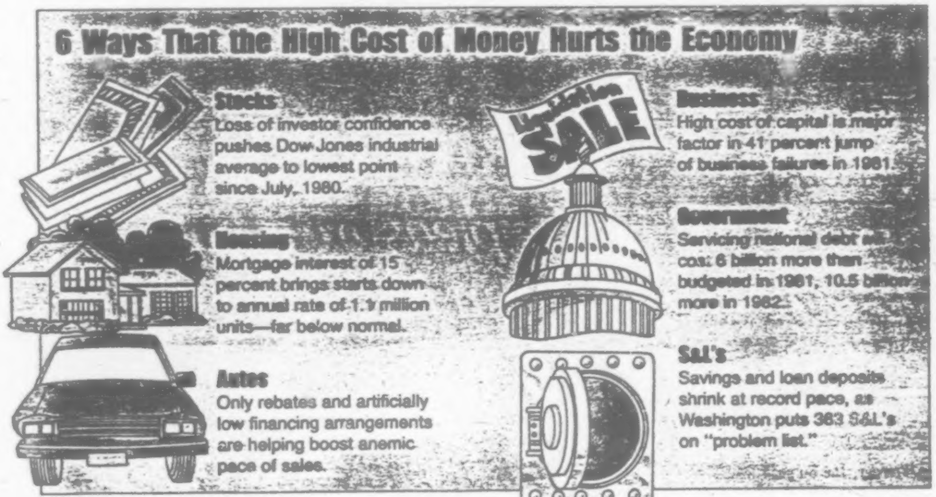
Adding to White House woes was the August 25 report that consumer prices shot up at a 15.2 percent annual rate in July, the steepest climb in 16 months. A chief culprit: High mortgage rates.

On Wall Street, investor enthusiasm over tax and spending cuts orchestrated by the White House evaporated and was replaced by fears that no substantial interest-rate relief was likely for months to come. Feeding that worry was the record 15.9 percent that the Treasury paid on August 24 to sell 4.5 billion dollars in six-month bills.

Twin tailspins. On the same day, the stock and bond markets went into twin tailspins. The Dow Jones Industrial Average plunged 20.45 points, sliding to its lowest level since mid-July, 1980.

Kruger, Inc., a paper manufacturer, postponed a public offering of 100 million dollars in new 25-year debentures. The city of Chicago, citing "poor market conditions," withdrew a 140-million-dollar note earmarked for assisting its debt-plagued transit system. Smaller localities were equally affected. St. Cloud, Minn., postponed a 10.6-million-dollar capital-improvements offering.

Interest rates, along with inflation, also are blamed for a startling increase



6 Ways That the High Cost of Money Hurts the Economy

Stocks
Loss of investor confidence pushes Dow Jones industrial average to lowest point since July, 1980.

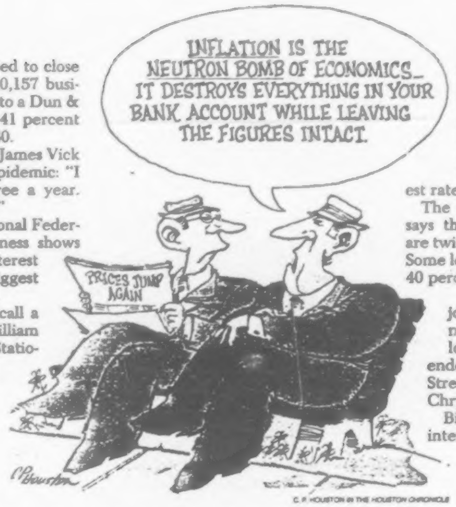
Housing
Mortgage interest of 15 percent brings starts down to annual rate of 1.1 million units—far below normal.

Autos
Only rebates and artificially low financing arrangements are helping boost anemic pace of sales.

Business
High cost of capital is major factor in 41 percent jump of business failures in 1981.

Government
Servicing national debt will cost 6 billion more than budgeted in 1981, 10.5 billion more in 1982.

S&L's
Savings and loan deposits shrink at record pace, as Washington puts 363 S&L's on "problem list."


INFLATION IS THE NEUTRON BOMB OF ECONOMICS_ IT DESTROYS EVERYTHING IN YOUR BANK ACCOUNT WHILE LEAVING THE FIGURES INTACT.
PRICES JUMP AGAIN
C.P. Houston

C. P. HOUSTON IN THE HOUSTON CHRONICLE

in the number of firms forced to close this year. By mid-August, 10,157 businesses had failed, according to a Dun & Bradstreet survey, a rise of 41 percent over the same period in 1980.

In Salem, Oreg., attorney James Vick attests to the bankruptcy epidemic: "I used to handle two or three a year. Now I'm doing one a week."

A new survey by the National Federation of Independent Business shows that for the first time interest rates were ranked as the biggest concern of small businesses.

"We're what you would call a mom and pop store," says William Warren, owner of Warren Stationery in Los Angeles. "It just kills us when interest rates are high. It kills my incentive to try to expand in any way."

Larger corporations, particularly those that supply the housing and auto industries, also feel the pressure from high borrowing charges. Weyerhaeuser Company of Tacoma, Wash., the nation's largest forest-products firm, has closed mills in Bly, Oreg., and Doswell, Va.—moves that cost 350 jobs. The lumber slump has propelled Oregon's jobless rate to 9.7 percent, far above the national average.

GAF Corporation, a large New York-based chemical and building-materials company, cites interest rates as the main reason for selling eight of its businesses.

Even the booming aerospace industry is affected. Slower sales due to high interest charges have forced Hughes Helicopters of Culver City, Calif., to suspend final assembly of model 300C helicopters for 60 days.

Utilities have it no easier. Baltimore Gas & Electric pulled back a 100-million-dollar offering in late August because of high interest rates. Brooklyn Union Gas Company decided to skip a 50-million-dollar bond issue.

Many of the nation's farmers are reeling from the pain of interest rates and lower crop and livestock prices. "This is the first year that farmers have experienced interest rates this high throughout the whole production season," says Marvin Duncan of the Federal Reserve Bank in Kansas City. "There is simply not enough profit in agriculture to withstand these interest rates for any great length of time."

The Farmers Home Administration says that delinquency rates on loans are twice as high as they were last year. Some loans had past-due rates of nearly 40 percent.

International Harvester, a major manufacturer of farm equipment, posted a 354-million-dollar loss in the nine-month period ended July 31, prompting one Wall Street analyst to label it "a barnyard Chrysler."

Biggest victim in the growing list of interest-rate casualties remains construction. Potential buyers refuse to pay mortgage rates of up to 17 percent, and builders are rebuffed by rates on construction loans as high as 24 percent. The result: Nationwide housing starts this year could fall below 1.2 million units for only the fourth time since 1948. Construction unemployment stands at 15 percent, and nearly 2,000 building firms have filed for bankruptcy in 1981.

"Interest rates have killed new housing," says Gerald Eid, a Moorhead, Minn., builder. Eid says he built 150 homes in 1978. "This year, we'll do about 20." He also has been forced to lay off 190 of the 200 employes who worked for him last year.

In Joliet, Ill., builder Lynn Krause has reduced his staff from 70 to four and hasn't taken a paycheck for nine months. He has sold six houses this year through use of "buy-downs"—a process whereby the builder subsidizes a portion of the interest cost. "If you didn't do it, you wouldn't sell any houses," says Krause.

Industries tied to home building also feel the pinch. "High interest rates are killing the home-furnishings business," says Jim Kittle, Jr., chairman of an Indianapolis furniture firm. "It's not fun to be in the business at a time like this."

Draining deposits. The traditional source of mortgage funds—thrift institutions—are in dire straits as depositors withdraw billions of dollars to seek higher yields from popular money-market funds and other investment vehicles. The funds—paying average interest rates above 17 percent—have collected more than 70 billion dollars this year, mostly at the expense of thrifts.

Federally insured savings and loans had net withdrawals of 11.3 billion dollars in June and July, a record, and mutual savings banks have already suf-

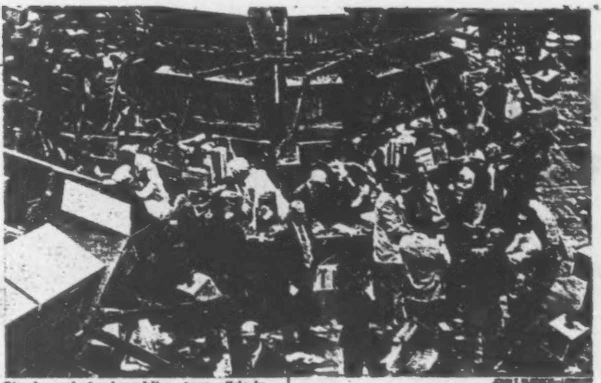
AP

Worries over the economy brought Budget Director David Stockman, above, and Defense Secretary Caspar Weinberger, right, to California to meet with the President.

ROGER SANDLER

AP

After Debacle On Wall Street, No Early Sign Of a Rebound



Stock-market prices hit a steep slide in the waning days of August.

Fears of yet another boost in interest rates caused a late-August nose dive in the stock market and left investors puzzled over when to expect a recovery.

On one day alone—August 24—the Dow Jones industrial average plummeted more than 20 points to 900.11, its lowest level in 13 months. Wilshire Associates, a California-based investment firm, calculated that the 5,000 stocks it monitors suffered a 40-billion-dollar loss from that slide.

On August 28, the Dow average closed at 892.22, 12.9 percent below the year's high on April 27.

The debacle followed news of an unexpected surge in the money supply during mid-August and a sharp jump in the inflation rate during July. Investors also were troubled by forecasts that the administration's tax cuts could boost the federal deficit to 60 billion dollars next year, creating prospects for heavier government borrowing.

More of the same. Credit-market analysts predict that these developments will force the Federal Reserve to maintain its tight grip on the nation's money supply, leaving interest rates no place to go but up.

The Fed's monetary policies have already pushed interest rates to near-record levels and made short-term money-market instruments all too attractive to investors.

Economist Astrid Adolfson of the New York investment firm of Bear, Stearns & Company explains that it is hard to justify going to the stock market when the government guarantees a return of 15 to 16 percent on Treasury bills and money-market mutual funds are paying more than 17 percent.

Others argue that the persistence of high interest rates has confused investors who had expected borrowing costs to fall this summer. High interest rates have created uncertainty, says Robert Brady of E.F. Hutton & Company, "and the stock market does not like uncertainty."

The big question: When will the market rebound? Adolfson says high borrowing costs are reducing corporate profits and hastening an economic slowdown that will further depress stock prices. "It'll be a while before you see a pickup in the stock market," she concludes, because investors "don't pay for low profits."

More hopeful is Steven C. Leuthold, who manages stocks for large investors as director of Houston-based Funds, Inc. He says that recent statements by the administration indicate another round of budget cuts this fall, which, he predicts, will rally investors.

Others feel that it will take a sustained drop in interest rates to restore investors' confidence in the equity markets. When rates finally do drop, say experts, certain stock groups could show big gains. These include interest-sensitive industries, such as banks, savings and loan associations, electric utilities and telephone companies.

Analysts also contend that lower interest rates would spur consumer demand for autos and home furnishings, boosting the stock of firms in those fields.

The administration believes that Wall Street is overreacting and not giving its economic recovery plan a chance to take hold. Reagan officials argue that the new tax law, rather than fueling inflation, will spur savings and investment and trigger business growth, making stocks more appealing.

Still, government and private economists agree that much depends on progress in fighting inflation. If price increases are curbed, competing investments will not have to carry as high a yield to attract funds, and the stock market will become more alluring.

By PATRICIA M. SCHERSCHEL with WILLIAM C. HARTLEY and ROBERT J. MORSE

fered their largest yearly outflow in history—8.1 billion dollars.

Underscoring this situation, the Federal Home Loan Bank Board's "problem list" of troubled S&L's reached 363 in June, twice as high as in 1980. In the Chicago area alone, 60 of the 190 S&L's may be forced to merge because of their weak financial status.

The auto companies, frantic to clear dealer lots of 1981 models, used customer and dealer incentives to boost sales during the first 20 days of August. But most analysts believe the shot in the arm is only temporary and that sales will fall again, much as they did in the spring following similar price cuts.

Donald Cooper, president of Kin Chevrolet in Brooklyn, says his business has been booming since General Motors offered 13.8 percent financing, compared with the New York-area average of 21 to 24 percent.

But Bud Hover, Jr., a Denver Ford dealer, couldn't wait for relief. He recently sold his business. "We were paying phenomenal interest rates on our inventory. It drove us out of business." Hover is among 2,600 auto dealers who have folded in the past 2½ years, according to the National Automobile Dealers Association in Arlington, Va.

Fueled by doubts. A major reason for the lofty interest rates: Fears in the financial markets that Reagan's economic plan won't work. Without spending cuts beyond the 35 billion dollars already trimmed for the fiscal year that begins October 1, analysts say, government will be forced to borrow more than anticipated to hold down budget deficits swollen by heavy tax cuts.

The administration expects to pay 108.6 billion dollars in interest on the federal debt in 1982. But if government interest-rate predictions are too low, as many believe, borrowing will soar.

If more funds are required, there will be a head-on collision with the Federal Reserve's pledge to keep a tight rein on the growth of the money supply in order to fight inflation. With the Fed refusing to budge, interest rates will remain high as the flood of federal borrowing makes it tougher for business and other borrowers to raise funds.

President Reagan has promised to hold next year's deficit to 42.5 billion dollars. But the Congressional Budget Office says that the red ink could climb 60 billion—about the level it was in Jimmy Carter's final year in office.

That's why the White House budget office has ordered government agencies to hold fiscal 1982 spending to about 4 billion dollars below the level authorized by Congress. Presidential aides predict, moreover, that Reagan will exercise his veto powers on congressional spending he considers excessive.

Pessimistic forecasts. Despite administration claims that the prime rate will fall from 20.5 percent to 15 percent by year's end, most economists see little relief. Some even say rates could go higher. Chief economist Norman Robertson of the Mellon Bank in Pittsburgh says the prime won't fall below 16 percent over the next year.

Allen Sinai of Data Resources, a Lexington, Mass., forecasting company, believes that interest rates will remain stuck at current levels "until inflation rates are permanently in the 6 to 7 percent range" or unless the economy goes into "total collapse."

That trade-off—continued suffering because of inflation or a deep recession—could threaten the Reagan recovery plan. It also could strengthen the hand of Democrats in Congress, who have been beaten in battle after battle against Reagan this year. ☐

By JAMES HILDRETH with MICHAEL DOAN and the domestic bureaus

Who Sets the Prime Rate? Why Is It So High?

Signs that lenders may boost their prime lending rate—now at a near-record 20.5 percent—have sent shock waves through the business and investment community. Why is the prime such a key economic barometer?

The prime rate—the interest that banks charge on short-term loans to their best customers—is a crucial bench mark because, for all borrowers, it is a measure of what is happening in the money markets.

For car dealers, manufacturers and other firms that borrow to finance their operations, a low prime rate spurs economic expansion by encouraging firms to seek new markets, build plants and hire workers. High rates not only discourage such expansion and eat into profits but also affect continuing operations, such as the financing of inventories.

Who qualifies for the prime rate?

A firm that has strong earnings prospects and an established track record of paying its debts stands the best chance of getting the prime rate. A banker may often give a discount of 3 or 4 percentage points off the prime to a preferred client—sometimes, a large corporation or a borrower willing to keep large deposits with the bank. Home builders and other high-risk borrowers are normally charged rates 2 or 3 percentage points above the prime.

How do banks set the prime rate?

Each bank has its own formula, but most lenders base their calculations on the cost of obtaining money used to make loans.

Checking and savings accounts are important sources of that capital, and the cost of attracting those funds ranges from virtually nothing in the case of noninterest-bearing checking accounts, to 5¼ percent passbooks, to certificates of deposit paying rates of 15 percent or more. Typically, banks then add 2 or more percentage points to cover overhead expenses and profits.

Big banks also take into account the cost of obtaining loan funds through the money markets and from other banks. The going rate on such interbank loans—called the federal-funds rate—is now about 18 percent.

Why is the prime rate so high?

Most economists agree that inflation is the main culprit. As prices of goods and services rise, investors demand a greater return on their money. For example, millions of small savers have put their nest eggs into money-market mutual funds, which now yield an average rate of about 17 percent, forcing banks to pay depositors more in order to be competitive.

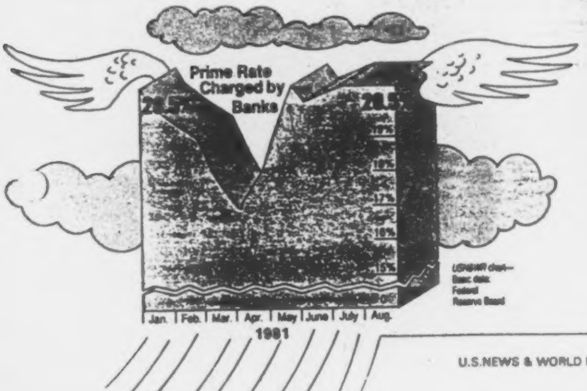
Government economic policies also exert upward pressure on interest rates. To bring inflation under control, the Federal Reserve is slowing the growth of the money supply, reducing the amount of money available to borrowers who bid up the interest rates. At the same time, the Treasury Department has had to borrow huge sums to finance the large federal deficit, reducing the amount of funds available for private borrowers.

Does the prime influence rates on auto loans and mortgages?

Rates on these long-term loans tend to track the prime rate, though are not as quick to rise or fall with it. Most banks and savings and loan associations make home and car loans with savers' deposits rather than with funds raised through the more volatile money markets.

Mortgage lenders in setting their rates also must consider the policies of federally chartered corporations that buy pools of home loans. For instance, the Federal National Mortgage Association is willing to buy mortgages with yields no lower than 16 percent. Interest rates on long-term loans and bonds also are closely related to prospects for inflation.

High Cost of Borrowing



USN&WR chart—Basic data: Federal Reserve Board

Senator **Sarbanes**. I thank all the members of the several panels. I particularly appreciate your patience in staying with us throughout the morning. I think it is important to have your helpful testimony in the record.

Mr. Morris, I want to say to you that I am extremely concerned about what this is doing to small business, about the sort of situation you were discussing. Every study shows that small businesses are the biggest originators of jobs and innovative ideas. I think it is very important for the general economic and social way we function in this country.

I think it is particularly helpful to have the kind of very graphic, personal story that you told us this morning.

We appreciate everyone being here with us.

Thank you.

We stand in recess.

[Whereupon, at 12:45 p.m., the subcommittee recessed, to reconvene at 9:55 a.m., Thursday, September 3, 1981.]

EFFECTS OF HIGH INTEREST RATES ON MARYLAND COMMUNITIES

THURSDAY, SEPTEMBER 3, 1981

CONGRESS OF THE UNITED STATES,
SUBCOMMITTEE ON INVESTMENT, JOBS, AND PRICES
OF THE JOINT ECONOMIC COMMITTEE,
Washington, D.C.

The subcommittee met, pursuant to recess, at 9:55 a.m., in the Forum, Harbor Campus Bard Building, Community College of Baltimore, Baltimore, Md., Hon. Paul S. Sarbanes (member of the subcommittee) presiding.

Present: Senator Sarbanes.

Also present: James K. Galbraith, executive director; William R. Buechner, professional staff member; and Betty Maddox, assistant director for administration.

OPENING STATEMENT OF SENATOR SARBANES, PRESIDING

Senator **SARBANES**. I think we will get started. We understood we were going to be in a room where we would be a little closer together than this but we have been assigned this lecture hall for now; but perhaps they may come up with a smaller room. We don't expect any hand-to-hand combat in these hearings, so we don't have to be separated by great distances. [Laughter.]

This is the fourth day of hearings that the Subcommittee on Investment, Jobs, and Prices of the Joint Economic Committee is conducting to examine and document the effects of high interest rates on Maryland communities. Earlier this week, we heard graphic examples from a wide variety of business and local leaders concerning how high interest rates have hurt local economies in Baltimore County, in Anne Arundel, and surrounding counties, in Montgomery County, and on the Eastern Shore, and yesterday we were in Rockville.

Today the subcommittee moves to the Community College of Baltimore, of which, as a digression, we are very proud. It is a leader in the field of education, and has been a trail blazer with respect to community colleges across the county.

In six separate hearings this week, we will hear from more than 80 witnesses about the severe challenge of high interest rates—a challenge which these witnesses know best since they face it daily in their own economic activities.

It is no exaggeration to say that the problems created by continuing high interest rates are approaching crisis proportions. The situation this year, with the prime rate remaining over 17.5 percent, is unparalleled. In the last 12 months the prime has been as high as 21.5 percent, and today it remains at 20.5 percent. The mortgage rate at many financial institutions is over 17 percent, the highest it has ever been. The interest rate on tax-free municipal bonds is now over 11 percent, twice that local governments had to pay only 4 years ago. These rates have created grave obstacles to the operations of many established and productive enterprises, particularly in those sectors of the economy which depend upon a line of credit. The damage thus far is serious; and, if conditions are not soon improved, will be irreparable. Enterprises which have been an important asset to their respective communities, an important economic resource, will be lost.

The burden of high interest rates has become a major financial problem for small businesses. Auto dealers and other sellers of consumer durables have been particularly hit. For the first time in the history of a quarterly survey by the National Federation of Independent Business, small businesses rank interest rates and financing as the single most important problem facing them. The survey which was released last week says: "The currently high rates of interest are making a bad situation unbearable for many small firms." Last year almost 12,000 businesses failed nationwide, the highest figure in more than a decade and almost double the number of failures in 1978 when interest rates were only half their current level.

The situation is particularly critical in the home-building industry. Housing starts last month stood at an annual adjusted rate of just over 1 million, down 17 percent from the already reduced pace of a year ago and only half the 2 million starts needed to meet nationwide demand. Construction-related business is similarly depressed. Unemployment in the construction industry is running at 15 percent, more than twice the industrial average. Home sales have fallen dramatically, down in Maryland as much as one-third from the levels of 2 years ago.

Financial institutions, particularly savings and loan associations, which have done so much to make home ownership a reality, face unprecedented pressure. High interest rates also have very serious implications for the finances of State and local governments. As a Sunday's New York Times article commented:

> These are dark days for State and local treasuries * * * Prices of municipal bonds have been sliding all year and fell to a historic low last week. At the same time, the interest rates that governments have to pay on their new bonds have reached historic highs.

This is an especially serious blow at a time when State and local jurisdictions must look forward to sharp reductions in financial support from the Federal Government.

The Federal Reserve Bank in Richmond reports that Maryland farmers are now paying the highest interest rate they have ever had to pay for bank loans, with many farmers paying 2 to 3 percentage points above the current prime rate. As a result, farmers across the State, as elsewhere in the Nation, have been postponing or abandoning productive investments which would make them more efficient and effective producers. And we heard some very pointed testimony on this subject yesterday at the hearing at the Chesapeake Community College in Wye Mills.

The purpose of these hearings is to document across the State, with testimony from those directly affected, the conditions to which these statistics attest. Over the past 18 months the Joint Economic Committee, created by the Employment Act of 1946 to provide Congress with economic information and advice, has held a number of hearings on the interest rate question, and will undoubtedly return to this matter when the committee, in the fall, begins its examination of the impact of the recently enacted economic program.

It is my hope and expectation that the record of the Maryland experience established by these hearings will make an important contribution to the committee's work and to the response to which policymakers must undertake to remedy this pressing economic situation.

We are very pleased this morning to have as our first witness the director of the Baltimore City Office of Intergovernmental Research, Janet Hoffman. That is not a title that fully sets out on its face all that Janet does and the influence that she wields, as all of us who know of her fine work are very much aware. But Mrs. Hoffman is representing Mayor Schaefer and, as I understand it, will also in a sense be speaking on her own behalf. And Janet, we are very pleased to have you here this morning.

STATEMENT OF JANET L. HOFFMAN, DIRECTOR, BALTIMORE CITY OFFICE OF INTERGOVERNMENTAL RESEARCH, BALTIMORE, MD.

Mrs. **Hoffman**. Thank you, Senator. Mayor Schaefer was very sorry he could not be here, but I am here to represent Mayor Schaefer and we are both very glad that you are undertaking this effort, because we think the effect of high interest costs——

Senator **Sarbanes**. Mrs. Hoffman, let me interrupt. They have a better room, and I think it would work better. So why don't we go there?

[A short recess was taken.]

Senator **Sarbanes**. Mrs. Hoffman, I think we're ready to proceed.

Mrs. **Hoffman**. I was about to say that the mayor is convinced, as I believe most people are, that there will be most serious consequences if high interest rates are allowed to go unchecked. The effects on the city are direct and indirect. You are going to be hearing from others about their specific sectors of the economy. And my role is to concentrate on the effect on the city government.

It is obvious that high interest increases the cost of a particular project, especially those projects which have to be financed over a protracted period of time, such major items as water and sewer projects, bridges, tunnels, long-range capital undertakings. High interest increases the cost of borrowing. Theoretically, you could say that a city could increase its tax rate in order to pay for the additional cost, or you might be able to say, "Well, the assessable base is growing, so it will be a proportionate increase." But, increases in interest cost have, as an absolute fact, outstripped the increases in the city's assessable basis, and thus require a constantly increasing share of the tax dollar.

We believe, in Baltimore City, that the property tax rate ought not be allowed to rise beyond $6 per $100 of assessed value. It is already perilously close to that. Therefore, any increase in the cost of borrowing has got to result in service reductions.

I have three tables at the end of my prepared statement which document what interest costs are for millions of dollars borrowed in 1961, in 1971, in 1981, and what they cost in terms of pennies on the tax rate for the average median dollars borrowed in 1961, 1971 and 1981.

The city has been a very prudent borrower. We have a general policy of not issuing more than $35 million of general obligation bonds once a year. We have improved our credit rating. We have driven down our maturity periods, the term of the bonds, from 15 years in 1961 to a little over 5 years in 1981. Notwithstanding all of those factors, the improved credit rating, the reduction in maturities, and the other good management techniques that we have employed, the cost per million dollars has tripled absolutely, and the cost on the tax dollars has tripled in relation to the assessable base, as those tables will document.

An older central city such as Baltimore suffers a special competitive disadvantage because of high land costs, high building costs and high tax rates. We have trouble in attracting developers. We need new investment to keep the economy going in the city and to restore what needs to be restored in the city. With the present high cost of money, the special incentives that we used to provide, UDAG grants, GO bonds where necessary, and other kinds of financial assistance are just not enough to overcome the high cost of money, in order to attract developers to the city. Thus the marginal edge is in favor of the suburbs or other large cities in other parts of the country.

High interest also creates a demand for the city to provide assistance to segments of the population to secure housing which otherwise wouldn't be available. We have been trying to help people in low- and moderate-income brackets to secure housing. We have authorized a $100 million program. Alex Brown was able to market only $50 million of that program, despite a 10½ percent rate and despite a 5-year put option. The demand for housing remains unsatisfied, and we are hoping to be able to market the remaining authorization before the year's end.

But we don't know whether or not we will be able to do so in the present situation.

The high interest rates have stalled our urban renewal programs. One example is a project planned for 99 units of market rate housing in Washington Hill; 10 units were built. The project ground to a halt. The cost of money made the remaining units in the project unfeasible.

Homesteading—shopsteading and homesteading—have both been adversely affected. We used to be able to provide with general obligation bond money at 7 percent or thereabouts, loans for about 20 percent of the cost of a house, leveraging that so that the homesteader could secure the remaining 80 percent from conventional financial resources. That no longer works. With interest rates at their present rates, we would have to supply 60 percent or more of the cost of an individual house to bring it in at the overall rate of about 8 or 9 percent. That is impractical, because of the severe limitation on the amount of general obligation financing available to us.

The same problem with shopsteading, and here we have a special problem, because some shopsteaders have gone ahead, relying upon the completion of the project, but the program ground to a halt. Therefore, we may have to use our precious CDBG funds in order to finish the project, so that those that have already been put in place will not be a net loss.

Our employee retirement funds are very badly affected by high interest rates. The market for the conventional securities, stocks, and bonds, in which the retirement funds were invested, has fallen, as you know, very badly. Lack of adequate performance in the retirement system funds is the result of the availability of money market funds and other modes of investment and also lack of investor confidence in the national administration's economic programs and its ability to bring inflation and high interest to a halt.

Poor performance in these funds inevitably requires increased public—taxpayer—contributions for the retirement systems. Like many retirement systems, ours is geared to the salary levels of the end of a worker's career, and failure of the system's funds to increase proportionately to salary increases can have a devastating effect upon the required level of taxpayer contributions to maintain an actuarially sound system. Our system is sound at present.

The high interest rates have changed the financial markets in our country and our tax laws in a way significant adverse to local governments such as Baltimore, in our attempt to market our own securities. Reduction of the Federal income tax rates, exemptions for the all-savers certificates, money market funds functioning at sky-high rates of return and a lot of new developments, all add up to major questions as to the future viability of the tax-exempt municipal bond market.

High interest rates have created an extraordinary demand for the use of public tax credit through industrial revenue bonds, pollution control bonds, and other devices to provide the benefits of tax exemption to what are essentially private projects. And it is ironic that we seek approval of these kinds of bonds, in order to attract and retain jobs in industry, while we are suffering from the adverse effects of a glut of tax-exempt issues competing with our own GO bonds and our own revenue bonds. Everybody is suffering in that kind of situation. Nobody gains.

We know that our future as a city depends upon our ability to finance capital improvements. We do have a deteriorating infrastructure, and we do need capital improvements to continue to attract and retain investment. But as things now stand, we face decreased borrowing in purchasing power terms, regardless of need. We face shorter maturities with an inequitable result, in terms of which generation is going to be paying for long-term improvements. And we face intolerably high interest costs.

That is the end of my statement, Senator. And I would be glad to supply any further information you may request of us. Thank you.

[The prepared statement of Mrs. Hoffman follows:]

STATEMENT OF JANET L. HOFFMAN

Senator Sarbanes and members of the Subcommittee on Investment, Jobs, and Prices: Thank you for the opportunity to appear before you this morning. Mayor Schaefer is unable to be here because of a conflict in schedule and I am here representing him as well as appearing in my own capacity.

We are especially pleased that you have chosen to examine the effects of high interest rates on the city of Baltimore because of the serious consequences such rates will have if allowed to go unchecked.

These effects are both direct and indirect. You will hear from subsequent witnesses about the effect of high interest costs upon various sectors of the economy. My remarks will be confined to the effects upon the Baltimore City Government.

High interest increases the cost of our capital projects, especially major undertakings (bridges, tunnels, sanitary facilities, etc.) which require financing over a protracted construction period.

High interest increases the cost of borrowing for capital projects. Theoretically a community might be expected to increase its tax rate or other revenue sources to bring in the additional funds needed to pay the added interest costs. Increases in interest costs have outstripped the increases in the City's assessable basis and thus require a constantly increasing share of the tax dollar. It is the view of the City Administration that the tax rate ought not rise beyond $6.00 per $100 of assessed value; an increase beyond that level is viewed as politically and economically counter-productive. Thus the additional pennies on the tax rate needed to pay high interest costs are in competition with all other budgetary demands. Service reductions are inevitable.

High interest rates are especially harmful to older central cities such as Baltimore. We are already at a competitive disadvantage with the suburbs by virtue of high land costs, high construction costs and high property tax rates. With the present high cost of money, special incentives that Baltimore used to be able to offer such as UDAG grants or other forms of financial assistance are not sufficient to attract development to the City.

High interest creates new demands for the City to provide assistance to particular segments of its population to secure housing which has otherwise been priced out of their reach. In an effort to assist persons of low and moderate income to find housing the City attempted to market $100 million of single family mortgage revenue bonds. Alex Brown was able to market only $50 million of these bonds at 10½ percent with a 5 year put option. The demand for housing is unsatisfied and we are hoping to be able to market the remaining $50 million before the year is out. We are unsure of the outcome.

High interest rates have stalled our urban renewal programs. In Washington Hill a 99 unit development had been planned for market rate housing. After ten units were built the project had to be halted. Even UDAG grants, when available, are not sufficient to reduce the financing costs for private developers.

In our well known homesteading program we used to be able to provide City loans from G.O. bonds at 7 percent for 20 percent of the project costs, to leverage private bank financing for the remaining 80 percent of the cost of the rehabilitated structure. This used to produce a total overall net result of about 8 percent for financing the homesteader.

In today's financial terms, with private financing available in the range of 18½ percent to 19 percent the City would have to put up 60 percent of the house cost to get the same effective rate. This is impractical because there are real limitations on the availability of general obligation bond financing to the City and the use of G.O. financing for this kind of purpose diminshes its availability for other needed municipal purposes.

We have the same problem with the shopsteading program. It is particularly difficult in areas where some of the work was done in the expectation that the full block would be completed as planned. We may have to use our limited CBDG funds to write down financing costs in some areas.

High interest rates have had a dramatically adverse effect upon recent performance of the city's retirement funds. The market for conventional securities (stocks and bonds) has been very poor partly as a result of high yield money market funds and other modes of investment as well as lack of investor confidence in the ability of the national administration's economic program to control interest rates and inflation. Poor performance in the city's retirement funds inevitably will require increased public (taxpayer) contributions to maintain the actuarial basis of the system. Like many retirement systems, our benefits are geared to salary levels at the end of a worker's career. Failure of the retirement systems' funds to increase proportionately to salary increases can have a devastating effect upon the required level of taxpayer contributions.

BALTIMORE CITY'S DEBT POLICY

The city has no legal debt limit; however, issuance of general obligation bonds must follow an attenuated procedures involving for each individual issue, approval by the State Legislature, proposal by the Mayor and City Council of a referendum, approval by the voters and appropriation by the Mayor and City Council.

The city is conservative in issuing debt. Since 1962 the city's policy is to sell general obligation bonds once annually in amounts which average $35 million. In the last six years the city has redeemed $18.7 million more than it issued.

It should be clear to all that $35 million buys far less capital improvements in 1981 than it did in 1962. The city has shortened its maturities as a response to higher rates. During a period of fiscal crisis for the older central cities of this country, Baltimore has succeeded in improving its credit rating. In April 1981 Moody's Investors Service, Inc. and Standard and Poor's Corporation rated Baltimore City as A-1 and A, respectively. Notwithstanding all these considerations the price of money is impairing our ability to finance needed improvements and the orderly replacement of our deteriorating infrastructure. It is also causing us to shorten debt maturities in a fashion that produces an inequitable burden on the present generation of taxpayers.

High interest has caused a revolution in the financial markets of this country and in our tax laws which may have significantly adverse effects upon the ability of local governments to market their tax exempt bonds at reasonable interest rates. Reduction of the federal income tax rates, exemptions for the all-savers certificates, money market funds functioning at sky-high rates of return and many other new developments all add up to major questions as to the future viability of the tax exempt municipal bond market.

High interest rates have created an extraordinary demand for use of public tax exempt credit through industrial revenue bonds, pollution control bonds and other devices to provide the benefits of tax exemption to what are essentially private projects. It is ironic that we seek approval of such bonds in order to attract jobs and industry or to retain existing ones while at the same time we are suffering from the adverse effects of a glut of tax exempt issues competing with our own general obligation and revenue bonds. Everybody suffers in this kind of financial market.

We know our future as a City depends upon our ability to finance capital improvements. The factors that we are now dealing with make our future clear:

(a) Less borrowing (in purchasing power terms—regardless of need).

(b) Shorter maturities.

(c) At a much more intolerably high interest cost.

TABLE I.—BALTIMORE CITY—COMPARISON OF 1961, 1971, AND 1981—AMOUNT OF GENERAL OBLIGATION ISSUES; AVERAGE NUMBER OF YEARS OF ISSUES; TOTAL INTEREST COSTS; AVERAGE INTEREST COSTS PER YEAR; AVERAGE INTEREST COSTS PER YEAR PER MILLION; AND INDEX

Year	Amount	Interest rate (percent)	Average term (years)	Total net interest costs	Average net interest cost per year	Average net interest cost per year per million	Index
1961	[1] $32,550,000	3.12	15.9	$16,158,218	$1,016,240	$31,220	100
1971	35,225,000	4.66	11.5	19,079,424	1,659,080	47,099	151
1981	35,000,000	10.00	5.48	19,183,404	3,500,621	100,017	320

[1] February issue; in 1961 there was also a December issue of $28,500,000 at 3.3 percent for 13.5-year average life. Prepared by Baltimore City Office of Intergovernmental Research: JLH: Sept. 1, 1981.

TABLE II.—BALTIMORE CITY—COMPARISON OF COST TO TAXPAYERS FOR INTEREST ON $35,000,000 GENERAL OBLIGATION BONDS ISSUED IN 1961, 1971, AND 1981

Year of issue	Average annual [1] interest cost—$35,000,000 issue	1 cent on property tax yields	Tax rate needed for interest (cents)
1961	$1,092,700	$346,866	3.15
1971	1,648,465	307,201	5.37
1981	3,500,621	374,615	9.34

[1] Using actual interest rates paid and actual maturities (see table I). Prepared by Baltimore City Office of Intergovernmental Research: JLH: Sept. 1, 1981.

TABLE III.—BALTIMORE CITY—GENERAL OBLIGATION DEBT—AND INTEREST PAID—1971-81

Year	Debt outstanding at year end (in millions)	Interest paid in year
1971	$492.9	$17,163,857
1972	500.5	18,058,670
1973	501.8	18,958,821
1974	500.6	19,499,399
1975	497.4	19,992,043
1976	496.8	20,699,996
1977	494.9	21,429,598
1978	489.8	21,591,720
1979	479.5	21,742,146
1980	522.2	21,747,611
1981	516.1	27,031,700

Source: Baltimore City Department of Finance; Bureau of Treasury Management, Sept. 1, 1981. Prepared by Baltimore City Office of Intergovernmental Research: Sept. 1, 1981.

Senator **Sarbanes**. Mrs. Hoffman, that is very helpful. Could we go to the tables in your prepared statement for a minute? They're really extremely really well done, and I think we should discuss them just a bit.

Mrs. **Hoffman**. Shall I describe them?

Senator **Sarbanes**. If you would, yes.

Mrs. **Hoffman**. All right. Table II of my prepared statement compares for 1961, 1971, and 1981, the amount of bonds that we issued: $32.5 million, $35.2 million, and $35 million. It shows the interest rate at which we marketed those bonds, 3.12 percent in 1961, 4.66 percent in 1971, and 10 percent in 1981.

Senator **Sarbanes**. It's important to note that the city has had a policy on the amount of bonds, I think, since——

Mrs. **Hoffman**. Since 1962.

Senator **Sarbanes**. To stay at or about the $35 million figure, which I think is highly responsible conduct, I must say.

Mrs. **Hoffman**. Well, it is hurting. We may have to move that. You know, that $35 million buys a lot less in 1981 than it bought in 1962. The average term of the bonds has decreased. In 1961—the bonds issued in 1961 average 15.9 years. In 1971, 11.5 years, and in 1981, 5.48 years.

The next column of the table shows the total net interest costs, and it also shows a change in the laws relating to assessment. We phased out a number of aspects of the personal property.

Senator **Sarbanes**. And then in 1981, we are back to $374,000. So in a sense, the base is stronger now, in that each cent on the property tax gives a greater return than it did 20 years ago, and yet our interest charges are triple what they were.

Mrs. **Hoffman**. Correct. For about a third of the construction. Table III shows the amount of debt we had outstanding at the end of each year from 1971 to 1981 and the amount of interest that we paid. In 1971, we had 493 million dollars' worth of debt outstanding at the end of the year. At the end of the decade this year or last year—no, this year projected, we have $516 million outstanding. The interest paid, however, has grown from $17 million in 1971 to $27 million in 1981.

Senator **Sarbanes**. So that's an additional $10 million in the city's budget each year for interest cost?

Mrs. **Hoffman**. And that it can be confidently expected to rise very rapidly over the next decade. We have the benefit in 1981 of the cost of money in 1965 to 1970.

Senator **Sarbanes**. Because you had the longer maturity span. Of course, as you go to the shorter maturities, you get much more locked into the current high interest rate situation.

Mrs. **Hoffman**. Correct. But we cannot market the longer term bonds.

Senator **Sarbanes**. Well, thank you very much. This has been very strong testimony, and we appreciate it. We particularly appreciate the careful thought that obviously went into preparing it. It's been very helpful.

Mrs. **Hoffman**. Well, thank you. We are very grateful that you are looking into this very serious problem.

Senator **Sarbanes**. Thank you.

We will now go to the panel of financial institutions. Bill Beasman, the president of the Savings Bank of Baltimore and John Moran is filling in for Bob Hecht from Baltimore Savings & Loan, and Don Walton is from the Post Office Credit Union of Maryland.

Mr. Beasman, why don't we start with you, and we'll just move right across.

STATEMENT OF WILLIAM A. BEASMAN, JR., PRESIDENT, ASSOCIATED MUTUAL SAVINGS BANKS OF MARYLAND AND PRESIDENT, SAVINGS BANK OF BALTIMORE, BALTIMORE, MD.

Mr. **Beasman**. Good morning, Senator, my name is Bill Beasman. I am not only president of the State savings association, but I am also the president and chief executive officer of the Savings Bank of Baltimore, one of the oldest institutions of its kind in the country, and also one of the most respected.

I am honored to have been asked to testify at the hearings on the impact of high interest rates on the economy. You have been furnished with copies of my statement, which sets forth the plight of our industry because of high interest rates. And I am talking about the national industry now, and not just the industry in Maryland.

In the interest of time, though, I will not read my prepared statement, but I will discuss it in an abbreviated form and add some very personal observations and sentiments.

Senator **Sarbanes**. Fine, your prepared statement will be including in the hearing record.

Mr. **Beasman**. The industry's position has been well publicized, and I need not elaborate on it to any great extent today. I am happy to say, however, that the savings bank industry in Maryland is healthy and has run counter to the national trend of heavy losses. We have had an advantage in Maryland, that is, the savings banks, in that we have corporate lending powers and also diversified investment powers not shared by thrift industry in general throughout the country. We have been one of the exceptions.

This flexibility has served us well, and continues to do so; however, the current extraordinary high interest rate environment is threatening the stability not only of the thrift industry but also the Nation's other depository institutions, and we can name them all, starting with the credit unions on up to commercial banks. They have been seriously weakened in their inability to generate or attract private capital that would allow them to enhance earnings and their competitive position.

Today, we are under siege. We are under siege by discouragingly high rates of inflation, destructably high rates of interest, and a dangerously unstable financial scene. These devastating interrelated forces are undermining performance. The industry has suffered large-scale deposit outflows, deteriorating earnings position; and faces the prospect of continued disintermediation, reduced earnings, and if prolonged, capital erosion.

Your inquiry, though, is concerned with the impact of high interest rates on your constituencies, and I must assume that based on these hearings the subcommittee will attempt to promulgate policies, programs, directives for legislation that would depress interest rates to more tolerable levels.

This is an admirable objective. However, I believe the attempt will be doomed to failure, if the focus is solely on the control of interest rates. You have heard many witnesses testify over the past several days as to the devastating effect high interest rates have had, and continue to have, on home financing, the building and construction industry, sales of automobiles, consumer goods and services, merchanants, businesses—particularly small businesses, and the near impossibility of starting a new business.

I will not attempt to add to or elaborate on that which has already been said. That testimony, some of which I read in the paper, I am confident, has been stated eloquently and forcefully.

However, as near as I can determine from what I have read and what I've heard on television, the discussions have centered on the symptoms of the disease, that is, high interest rates, rather than on the disease itself. The illness that afflicts us, quite simply, is the unwillingness or the inability of governments and consumers to curb their appetites, that is, reduce expenditures in line with revenues, thereby eliminating an increase in total public debt.

Ever-increasing public debt is the silent killer of the economy. And we need not dwell on it, but we can go back to 1900 and look at the increase in outstanding public debt and note the direct correlation between it, and rates of inflation and high interest rates.

As you well know, interest rates are set by market forces—that is, the basic economic laws of supply and demand—which, until now, have been immune to legislation. High interest rates result in demand for capital that exceeds supply, that is, the savings of individuals and corporations. Although inflation is considered the culprit, it is the result of the same excesses, and exacerbates the interest cost problem. Therefore, if we do anything to reduce the destructively high rates of interest, we must look to the root causes of escalating rates, and not at those who allocate the available capital. Government must set its house in order before it can demand the same from its people.

I have kept my comments brief. I think I have focused on the real issue of interest—the cause of high interest rates and inflation—and I have not attempted to discuss all the various problems that confront people today. However, in closing, there are some positive aspects of high interest rates, and I think there has been a lack of those kinds of comments and discussions that have been heard to date.

For the first time in over four decades, savers—those who provide the capital essential to our form of economy—are participating in the post-Word War II prosperity. All other participants—labor, governments, real estate developers, home buyers, manufacturing concerns—have reaped the harvest of the prosperity since World War II, while the saver, the thrifty individual who made the prosperity possible in the first place, was limited to a return, until very recently, less than what his savings would have earned in the early 1900's. The savers now are enjoying what other sections of the economy have been enjoying for 40 years.

Also, and this is somewhat of a personal, philosophical observation, for the first time in over a quarter of a century, people are beginning to appreciate what a treasure it is to be able to buy and own a home. The purchase of a home with no money down, at subsidized interest rates, was taken for granted. It was easy to buy a home, and has been as easy to buy a home up until recent years, as it was to buy an automobile or a dishwasher.

Now, it is realized that sacrifices must be made if one is to acquire a treasure that few people in the world are permitted to own. Some may scoff at that notion. Some may even scoff at that remark. And they are going to collar me, I know, after this meeting.

But I believe that the acceptance of the sacrifices is a small step in the direction of reducing interest rates, and inflation. I am sorry if I don't voice the extreme pessimism and dark concern that many of the witnesses probably have evidenced prior to my little discussion. It is because I am an incurable optimist. I have great confidence in the good judgment of people, and when the chips are down, the people always end up doing that which needs to be done. And I think we have reached that point now.

And I believe it is also evidenced by the hearings that you are conducting now, Senator. And with those remarks, I am ready to respond to any questions—not only about my oral presentation, but that of my prepared statement. And I thank you very much for your attention.

Thank you, Senator.

Senator **Sarbanes**. Thank you, Mr. Beasman.

[The prepared statement of Mr. Beasman follows:]

Prepared Statement of William A. Beasman, Jr.

Mr. Chairman, my name is William A. Beasman. I am president of the Associated Mutual Savings Banks of Maryland, and president of the Savings Bank of Baltimore. Savings banks operate as non-stockholder, community-oriented financial institutions in Maryland and sixteen other states. In areas such as the Northeast, where they are most heavily concentrated, savings banks are the largest holders of consumer savings, as well as the dominant mortgage lenders, among the various types of depository institutions. Reflecting their urban orientation, the savings banks in Maryland are all Baltimore based, and have approximately $2 billion in total assets.

You and your colleagues on the Joint Economic Committee are to be commended for holding this important series of hearings on the impact of prolonged high interest rates on the economy. It raises critical issues for all Americans, and I am especially appreciative of this opportunity to discuss the impact on thrift institutions and our community lending activities.

In the course of my testimony I will first outline the general condition of the savings bank industry and then discuss how our experience in the State of Maryland differs somewhat from the national trends. Next I would like to describe the reasons why the savings bank performance in this State is considerably better than the national norm, and conclude by suggesting some federal policy changes which could strengthen our nation's thrift system and thereby contribute to the task of economic revitalization.

CONDITION OF THE SAVINGS BANK INDUSTRY

As has been amply documented in the financial as well as the general press, the thrift industry today is clearly under siege. Years of double digit inflation and destructively high levels of interest rates have combined to undermine the performance of institutions oriented toward savings and long-term lending. Savings banks and savings and loan associations have already suffered large scale deposit outflows and a major deterioration in their earnings positions. Unless this high interest rate climate cools down soon, many thrift institutions and not a few small commercial banks, which have balance sheet structures similar to those of thrift institutions, will be facing conditions that threaten their continued independent existence.

A cursory glance at savings bank deposit flow data is more than sufficient to demonstrate this point. For the first seven months of this year, the industry's net deposit loss amounted to $8.1 billion, thus surpassing the all time record outlflow for a full calendar year of $7.0 billion registered in 1979. Funds are flowing out for the simple reason that savings banks cannot match the rates available to investors in the open market or through such intermediaries as money market mutual funds. The inability to pay competitive rates is, of course, a result of the depressingly low earnings from past investment patterns, primarily long-term, fixed-rate mortgages.

With respect to earnings, the data is equally dismal and potentially more serious. Reflecting sharply increased interest payments on market-linked 6-month savings certificates, more than one-half of the nation's savings banks are now reporting bottom line losses. In the first six months of 1981, the industry recorded an annualized loss as a percentage of assets equivalent to .64 basis points. For 1981 as a whole an industry-wide loss of 75 basis points on assets, or approximately $1.3 billion of red ink is estimated.

The situation in the savings and loan industry, as recently reported to the House Banking Committee by Federal Home Loan Bank Board Chairman Richard Pratt, is equally bleak. In his July 14th statement, Chairman Pratt stated that 74 percent of all savings and loan associations are incurring net operating losses and undergoing an erosion of surplus positions.

It should be stressed that the thrift industry's current problems are not at this time posing a danger to depositors who are protected by federal deposit insurance up to $100,000 per account. The danger, rather, is that the current level of high interest rates will continue unabated and eventually lead to economic and financial crisis in this country.

MARYLAND SAVINGS BANK EXPERIENCE

Turning from the national experience which is heavily influenced by developments in major money centers such as New York, Boston, Chicago, etc., I am pleased to report that savings banks in Maryland have been able to turn in a performance that, while certainly not robust, is counter to the national trends of heavy losses for thrift institutions. Although savings flows, excluding interest, were a negative 2.46 percent of total deposits outstanding for the period January to July, 1981, earnings are still in the black. Surplus positions at Maryland savings banks increased 0.06 percent as a percent of average assets in the first quarter of 1981, and actually increased to .12 percent in the second quarter of this year.

Notwithstanding the fact that savings banks in Maryland have fared better than our counterparts elsewhere, the fact is that our housing and community lending programs have had to be curtailed drastically in the face of the adverse operating conditions previously described. Mortgage commitments are at their lowest level in recent memory and, as a consequence, homeownership opportunities for Maryland residents are shrinking rapidly.

SAVINGS BANK OPERATING POWERS

Analyzing the savings bank experience in Maryland as compared to their institutions nationally lends one to conclude that a major reason for our relatively strong performance can be found in the expanded operating and investment powers granted under state law. Savings banks in Maryland were able to offer checking accounts to their customers long before transaction accounts were authorized for thrift institutions on a national basis. Such deposits add a stable core of lower-cost funds to a bank's liability structure and, perhaps even more importantly, permit us to meet the full range of our retail customers' needs.

In Maryland we have also had the advantage of corporate lending and demand deposit authority, as well as the ability to diversify into several lines of bank-related activities such as leasing. Broad and flexible asset powers have given savings bank management the opportunity to balance their mortgage portfolios with shorter-term, higher-yielding loans. Statewide branching and conditions of approximate competitive equality with commercial banks have permitted our institutions, at least to some extent, to insulate themselves from some of the inflation-induced problems which now plague thrift institutions generally.

It is encouraging to see that the example set by Maryland and several other states in which savings banks operate, such as Connecticut, Maine and New Jersey, is now being adopted at the federal level. The 1980 Depository Institutions Deregulation and Monetary Control Act granted additonal deposit-taking and investment powers to federally chartered thrift institutions. This authority, which includes NOW accounts, consumer lending, and limited commercial banking powers for federal mutual savings banks, was sorely needed by the nation's thrifts. The problem is that deregulation on the asset side at the federal level may have been a case of "too little too late" for most thrift institutions to avoid being severely weakened by current economic conditions.

Essentially, it comes down to a question of timing. Deregulation of deposit liabilities has been proceeded apace since 1978 when market-linked certificates of deposit were first introduced. Current deposit deregulation under the auspices of the Depository Institutions Deregulation Committee is likewise moving with all deliberate speed. The fact remains, however, that thrift institutions need time to prepare for a fully deregulated environment. Lacking the powers and the competitive opportunities which we have had in Maryland, these institutions simply need more time to turn over their portfolios dominated by long-term, low-yielding mortgages. As these mortgages are paid down, thrift institutions will then be able to implement recently authorized broadened asset powers, including more flexible mortgage contracts, and thereby become fully competitive with the other providers of financial services in the marketplace.

In the interim, Mr. Chairman, it is most important that federal financial regulators and the relevant congressional committees, such as the Senate Committee on Banking, Housing and Urban Affairs on which you also serve, be fully congnizant of the current precarious state of the thrift industry. If I could leave one message with you today, it is that the imbalance between a rapidly deregulated deposit market and continuing asset restrictions must not be exacerbated.

PUBLIC POLICY RECOMMENDATIONS

The pro-savings features of the recently enacted Economic Recovery and Tax Reduction Act should go far toward restoring individual incentives to invest in savings institutions and other depositories. The All Savers provisions, in particular, should provide some much needed immediate relief to operating margins at savings banks and other thrifts, while also serving to reverse the heavy deposit outflows of recent years. We also consider the expansion in retirement accounts both with respect to eligibility and annual contributions' limits to be very signficant.

The savings bank industry strongly endorses the efforts being made by the Federal Home Loan Bank Board Chairman Richard Pratt to secure restructuring legislation that would remove the remaining restrictions on investment powers of savings institutions and thereby create full operating parity with commercial banks. When market conditions permit we also believe that all regulated depository institutions should be permitted to offer financial services comparable to that now provided by money market mutual funds. These and other changes will permit the thrift industry to emerge from the current crisis armed with sufficiently broad and flexible asset and liability powers to enable them to meet all the financial needs of our citizens, business entities, and our local communities.

Many individuals, and some thrift industry executives as well, would no doubt, yearn for a return to the "old days" of specialized depository institutions and a highly regulated financial structure. However, this is simply not a realistic option in today's world where banks must do business in competition with securities firms, insurance companies, national and, indeed, international financial conglomerates.

For the near term, in which restrictive monetary policy remains the principal tool of the federal government's anti-inflation efforts, interest rates will very likely remain unacceptably high and volatile. The federal regulatory authorities and the Congress will, therefore, have to remain extremely vigilant to ensure that the thrift industry as a whole will make it safely through the transition to a deregulated financial system in the years immediate ahead.

Senator **SARBANES**. I think we will hear from the other two members of the panel and then we can have a general discussion with all three of you. Mr. Moran.

STATEMENT OF JOHN G. MORAN, SENIOR VICE PRESIDENT, BALTIMORE FEDERAL SAVINGS & LOAN ASSOCIATION, BALTIMORE, MD.

Mr. **MORAN**. Baltimore Federal thanks you for the opportunity to be able to participate and comment today on the economic conditions which are prevailing, and also which are impacting homeownership. This series of meetings is very timely.

I brought with me today two current issues of business publications, the current issue of Forbes, and also the current issue of Business Week. Both of these have cover stories which talk about the impact of high interest rates and inflation on the housing industry.

I would like to read two very short paragraphs, if I may, from the issue of Forbes, from an article by William Baldwin. They, I believe, sum up—whether you are in Baltimore City or the State of Maryland, or anywhere in the United States—the plight that is affecting the consumer as well as the plight which is affecting those of us in the industry.

It reads:

> Jessie and Don Feature have given up looking for a house near Chicago, because on their combined $35,000 income they cannot afford one. The cheapest house they could find was about $75,000, and with today's 17-plus percent interest rates, that would have cost $900 a month—half of their take-home pay. That wouldn't do, so they will stay in their two-bedroom apartment. Jessie is pregnant with her first child, in Chicago's lower middle-class Roger's Park. They will wait for a more hospitable credit market along with a few million other Americans.

Then the second paragraph relates to the industry:

> In California, home builder Scott Biddle has been auctioning off unsold tract homes at distressed prices. He expects to lose several million dollars on the 605 units he built last year. When interest rates went above 12 percent, people stopped buying, he says.

There should be no question in anyone's mind that interest rates are high in the State of Maryland, and that they directly affect the consumers. Baltimore Federal is a savings and loan association, and it is very much community-based. And our interest rates, I think, are very much typical of those that prevail throughout the industry and that the consumer is confronted with, and has been confronted with for many, many months.

For example, a fixed-rate, fixed-term mortgage at Baltimore Federal up to 30 years is now 18 percent plus 3 points. The new adjustable mortgage loans—AML—of 1 year are 17½, and 3 points. That AML allows for the interest rate, and the payment, to adjust yearly. And our adjustable mortgage loan for 3 years is 17¾ percent and 3 points.

Basically, we are out of the housing market at this time. Those rates make it prohibitive for anyone to secure financing. The only loans we are making now are basically loans where we have had prior commitments to builders at lower rates, or where we are experiencing buydowns. The average consumer has been eliminated from the market.

On the other side, we are confronted with high rates that we are paying to our savers and our investors. And I agree with Mr. Beasman that this is necessary, and it is something that the consumer, in effect, deserves with respect to the inflation rates that prevail today. But when you look at the savings and loan industry and the portfolio that we carry of low-rate mortgages, and that we have been carrying for years on our books, and then suddenly are confronted with these short-, high-term rates, it becomes a disastrous situation for the industry.

Again, to give you some examples, if we look at the 6-month, $10,000 money market rates that are prevailing today, this week, the certificates are paying somewhat less than 16 percent, just a hair below 16 percent. The new rate that was announced on Tuesday for the 2½ year small saver certificates—these are the 30-month certificates that are available for a minimum as low as $100—are paying 16½ percent rate. But if you compound that over the full 2½ years that the certificate lives, that compounds out to 20¼ percent. That money that we are bringing in now in those small saver certificates will cost us 20¼ percent over a 2½-year period of time. So this is not a short-range problem.

But, we are looking for relief now. We hope that relief will be coming in terms of the high interest rates. It is a long-term problem for our industry, both in terms of the mortgage portfolio that we carry and also in terms of the high rates for savings that we are paying now.

Bob Hecht, our chairman of the board, was to be here today. He is unable to be with us, and he asked me to sit in in his place, and I respectfully request his prepared statement be entered into the record.

Senator SARBANES. His prepared statement will be included in the record at the end of our colloquy. It is a very good statement. I have had a chance to look through it.

Mr. MORAN. Also, to relate to what Mr. Beasman said, we see that it is a problem of supply and demand. It's not only supply and demand of money but, to get back to the comments that the Senator made earlier, we are expecting somewhere in the range of 2.6 million housing units to be needed each year through the 1980's, and at this point in time there is no prospect that we as lending institutions are going to be able to support that—nor will our colleagues in the building and real estate industry be able to support that, either. Something has to be done to make the money available, to make housing affordable, and to bring it to the marketplace.

How did we get into this situation? I think none of us will question that inflation has brought us to it, and in order to solve the problem, we have to get at the root of inflation.

But again, to go over what has been mentioned before, part of the problem we are experiencing today is the solution to the problem. The Federal Government, the Federal Reserve, and the administration in Washington today, are solving the problem basically through monetary policy, and the monetary policy that they are pursuing is one that has not traditionally been pursued in the past, namely a policy which targets on the supply of money without taking into consideration the level of interest rates. So every week we look at our newspapers, the Wall Street Journal, and different reports, and find out where MIA and MIB are, and we see the interest rates bouncing up and down, but keeping up there at a high level.

There doesn't seem to be any hope, at least from what we hear from Federal Reserve comments, that that situation will change in the near future. Until that does change, the interest rates will remain high, mortgage rates will remain high, and housing will not be affordable. What would we like to see done?

We would like to see something done that will help not only the thrift industry, but will help the consumers, and will help, specifically, here today, the people of Baltimore City. And we have listed some six items, but they are only general items. We could give you a whole specific shopping list, but let me just list them for the people we have here today:

We are asking that the Government pursue a monetary policy that gives consideration to the stifling effects of high-interest rates.

We are asking the Government to pursue fiscal policies to balance the budget and hold down inflation in the future.

We are asking that assurance be given that the Depository Institutions Deregulation Committee [DIDC] adhere to the Depository Institutions Deregulation and Monetary Control Act of 1980. We welcome the content of that act. We agree with the deregulation of financial institutions to bring us to competitive market positions on both the asset and liability side, but we do ask that that body that was appointed, the DIDC, adhere to the intent of that law. And we were glad to see that some action was taken recently in that respect.

We would also ask that there be some time and coordination given to the deregulation of assets and liabilities. Our liabilities, which are our savings deposits, are being deregulated very, very quickly. Our asset side—and in our case, where we are holding mortgages for 20 and 30 years—is being deregulated somewhat more slowly, causing us problems.

We are asking that methods and tax considerations be given to us for removing of low-rate mortgages from our portfolios.

And we would like to see, if possible, a definite continuation beyond December 31, 1982, of the consumers' ability to invest in the all-savers certificates, the tax-free certificates that will become available on October 1 at the depository institutions.

We realize Congress can't do this alone. We ask Congress, we ask the administration, we ask the Federal Reserve, to join with the financial institutions, and, as Bill Beasman mentioned, we also need a certain amount of cooperation and restraint on the part of the public and the consumers in order to achieve stability in the financial markets.

Senator SARBANES. Thank you for a very helpful statement. As I said, Mr. Hecht's prepared statement will be included in the record at this point.

[The prepared statement of Robert E. Hecht, Sr., follows:]

PREPARED STATEMENT OF ROBERT E. HECHT, SR., CHAIRMAN, BALTIMORE FEDERAL SAVINGS & LOAN ASSOCIATION

Thank you for the opportunity to comment on the economic conditions which prevail today, and which are impacting homeownership in America.

I come to you from a unique vantage point. As chief executive officer of a billion dollar savings and loan, I can comment on the economic impact at the local level, how it affects a savings and loan and how it affects individuals and families. As vice chairman of the Maryland Savings and Loan League, I can give a somewhat broader view of the economic impact among thrifts. And, as a member of the Ececutive Committee of the United States League of Savings Associations, I can add a national perspective to my thoughts.

Housing in America, today, is in trouble. When housing is in trouble, our economy is in trouble, and the Great American Dream of the nation's families is threatened. If we are to prosper as a nation, and if we are to preserve our traditional values, we must return the stability to our financial markets that will allow for needed vitality in the housing industry.

Congress is charged with the responsibility of writing and enacting those laws which provide for the political, economic, and social order of our country. In this role, Congress can not only pass but can change or repeal laws which are no longer relevant or necessary. However, there are some "natural laws" which are beyond the control of our elected or appointed officials and must be considered when enacting legislation. One such law is the "Law of Supply and Demand" which is the basis of all economic activity.

As we look at the problems of the housing industry today, we are really looking at a problem of supply and demand. For example, the demand for new housing is said to be 2.6 million units a year. In today's economic conditions, it is impossible for lenders and for our colleagues in the real estate and building industries to meet that demand.

1981 housing starts have dropped to record low levels, less than a million on an annual rate. Mortgage rates in excess of 17 percent persist. House prices are inflated. Buyers are unable to qualify for mortgages and sellers are unable to realize the equity they have invested in their homes. We are all in a "no-win" situation, one that cannot be allowed to continue or deteriorate further.

How have we reached the difficult position we are in today? There are a great many factors that contribute to this crisis in housing, but the most notorious is inflation. In the days before double-digit inflation, savings and loans grew and developed into the primary source of residential mortgage money. You and I, our families, and members of our communities deposited our savings into thrift institutions because they were an integral part of our community and because they were safe. With low rates of inflation, there was an incentive to save money. Savings and loans were able to pay an interest rate that more than offset inflation in those "golden days."

Thrifts then took that money and invested it back into the local communities in the form of residential mortgages. There was a balance between the supply of and the demand for mortgage money that made home ownership possible and affordable. I do not wish to imply that our system operated smoothly because there was no government regulation. Quite the contrary. We were heavily controlled by government regulations. For example, injunctions like Regulation Q limit the amount of interest financial institutions can pay on deposits. These regulations originally placed no hardship upon us nor did they place any undue restrictions upon savers, for savers received a fair real rate of return on their deposits because of the low inflation rate. At the same time we were, therefore, able to make mortgages at low rates for up to 30 years. Since 1980, through the Depository Institutions Deregulation and Monetary Control Act, we have experienced accelerated deregulation of our business. But this deregulation does not provide for a timely balance between assets and liabilities.

As a result, the cost of our funds has sky-rocketed, and in turn we have had no alternative but to offer mortgages at increasingly high rates. The demand for housing continues because of family formations, divorces and single-person ownership, but the supply cannot be achieved at a reasonable cost.

Because of the high rates of inflation we have experienced for the last several years, savers and investors have become much more conscious of interest rates and have turned toward instruments that can offer them double-digit rates of return. For financial institutions that means there has been deposit growth in short term certificates, but a large amount of money is being directed from depositories to Money Market Mutual Funds. They are a creation which has filled a void in the marketplace and at the same time greatly diminished our supply of lendable funds which in turn increases the cost of home financing.

Recognizing that inflation is problem that affects all sectors of the economy, the federal government, and particularly the present Administration, has taken dramatic steps to stabilize prices. I applaud their goals, but I disagree with several of their policies. Whether implicitly or explicitly, housing is no longer a government priority. I can appreciate that priorities can change as the times change, but, when we affect an industry that so completely permeates our economy, we cannot tolerate abrupt changes in direction. Housing has not caused the economic problems of today, and housing should not be called upon to carry the weight of solving these complex issues. Housing can and should remain a priority. Creative solutions such as the All Savers certificate will help, but we need more.

Housing is not affordable for the reasons I stated earlier: inflation and a lack of savings flows into thrift institutions, but we also have a third factor contributing to the problem. That factor is the tight money policy that is currently being pursued by the Federal Reserve with the blessing of the administration. The Federal Reserve, in its efforts to control inflation, is pursuing a monetary policy which emphasizes the money supply and not the level of interest rates. While this policy in the view of many economists has the potential of alleviating inflation in the long run, to date it has been devastating to industries such as housing and automobiles.

With the prime rate exceeding 20 percent, it is not realistic to assume that mortgage lenders can make funds available to families at affordable levels. Not only have thrifts been affected, but these same high interest rates have had a tremendous impact on the bond market and in cases such as Baltimore City, this has had serious and negative consequences for housing. For example, in its quest to make housing affordable to low- and middle-income families in Baltimore City, the City in cooperation with private interests developed an innovative bond program to support low interest mortgages by private lenders. But because of high interest rates, this bond program was delayed for more than a year in coming to market, and when if finally did come to market just this past July, it was cut back to 50 percent of its projected level. That 50 percent reduction equates to $50 million less that is available to support home ownership for low- and middle-income families. This is just one obvious and visible example of the effects of the current tight money policy. But how many less visible examples do we have of families who have been turned away from the reality of home ownership?

Baltimore City has experienced a renaissance: a rebirth of spirit, a reawakening of pride, a rebuilding of its neighborhoods. The avilability of mortgage funds in the past at reasonable rates has made possible our very successful homesteading program, and the revitalization of our Inner Harbor.

These programs, made possible through monetary policy that did consider the level of interest rates, brought many benefits to our City and its people: the pride of home ownership, improved neighborhoods, employment, increased tax revenues, and a nonquantifiable sense of vitality. We cannot afford to lose that momentum.

To recap briefly: our housing priority has been destroyed by our economic policies to combat inflation. Inflation has battered the housing industry by raising the prices of houses, by increasing mortgages rates, and by diverting savings from thrift institutions. Are there any actions we can take to ameliorate these negative effects? I think there are.

Pursue a monetary policy that gives consideration to the stifling effects of high interest rates;

Pursue fiscal policies to balance the budget;

Assure that the Depository Institutions Deregulation Committee adheres to the Depository Institutions Deregulation and Monetary Control Act;

Coordinate the deregulation of assets and liabilities;

Provide methods and tax considerations for removing low rate mortgages from savings and loan portfolios; and

Continue indefinitely beyond December 31, 1982, the consumer's ability to invest in tax free certificates at depository institutions.

These are the challenges we face: Congress should pass those laws which promote a vigorous and healthly economy while recognizing and preserving the valuable role of the housing industry; the Administration should pursue responsible fiscal and monetary policies; savings and loans should prudently incorporate those new powers which will allow them to meet the financial needs of families in then communities, and the public should demand responsible action and to cooperate to bring stability to our economy.

Our tasks are not easy, but I am confident that we can achieve our goals to the benefit of all.

Senator SARBANES. Let me make just one comment before we hear from Mr. Walton. I have the perception, frankly, that the high interest rates, designed to check inflation, are in fact contributing to it. The rates that the Fed has established are now so far above the current level of inflation that the real rate of return is very high in historical terms. So that you have a gap in there that is prevailing.

Last month, the CPI went up 15 percent. It is tricky to annualize from a single month, and I don't want to make any more of it than one ought to.

But if you look at the components of the CPI, and say, "Where did that come from?" the single biggest factor, was the high cost of housing, which, again, reflects the high-interest rates. We also heard testimony that it is not only the carrying cost, but on the other hand there is creative financing, or situations where you can assume an existing mortgage, and these are simply reflected in higher costs for the house. So that too inflates the housing cost.

Second, to the extent it affects fiscal policy, and the effort to move to a balanced budget, the high-interest rates, if they provoke recessionary trends in certain sectors of the economy, or cause people to lose jobs, so that they cease to be wage earners and taxpayers, and start drawing unemployment. Builders have testified very graphically that they are laying off carpenters, plumbers, electricians, and so forth. The net result is that they no longer pay money into the Tresury on the one hand, and on the other they turn around and draw money out of the Treasury for the various unemployment or other income support programs, thereby automatically contributing to a worsening fiscal situation for the Federal Government.

No one is arguing for a "the-doors-are-wide-open" approach, but it seems to me we're going to have to get some sort of adjustment that enables established concerns to function in a reasonable way.

A little later we will be hearing from the operating businesses, and I will be interested to hear their comments. But the testimony we have been receiving is that the people affected today are not the marginal people. The people being affected now are old line, established, highly regarded, effective operators in their particular lines of work, particularly in those sections of the economy that are heavily dependent on credit to function.

Don Walton, will you proceed?

STATEMENT OF DON WALTON, MANAGER, POST OFFICE CREDIT UNION OF MARYLAND, INC., BALTIMORE, MD.

Mr. **Walton**. Senator, I appreciate the opportunity to testify this morning on a subject that so vitally effects the credit union industry in general and this credit union in particular.

My name is Don Walton. I'm the manager of the Post Office Credit Union which serves the postal employees of this area and is the oldest credit union in the State of Maryland. The credit union is a relatively small one, with around $7 million in assets.

Although high interest rates have been around for some time, our credit union is just beginning to face the problem associate with high interest rates, disintermediation of funds.

Over the past 2 years, the credit union has increased it asset size at a brisk 20 to 25 percent per year. At the beginning of the summer, withdrawals began to accelerate relative to the same period a year ago. In August, withdrawals were $110,000 more than in August 1980.

Our assumption, of course, is at most of the withdrawals are being redeposited in higher-yielding CD's and money market funds. In order to stem this tide, we will have to offer CD's and/or higher rates on our savings accounts. Paying higher interest rates affects our bottom line directly. We have to offset that expense by raising the rates on our loans.

Whether we can maintain a sufficient spread between our yield and the cost of funds remains to be seen. Many credit unions are forced to work with narrowing spreads, and S. & L.'s are face with negative spreads.

So the problem is very real, but at this time we are optimistic about our ability to deal with it.

As we raise our rates to cover our expenses, we see that it is the borrower, the consumer, who must bear the cost of high interest rates. Our loans are primarily personal and auto loans extending to 4 years and less.

We have been fortunate that our asset size did not allow us to get into long-term mortgages and subject us to the real ravages of borrowing short and lending long in the face of rising interest rates.

Our auto loans used to be for a maximum of 36 months. But an $8,000 loan at 15 percent of 36 months comes to $277 per month. Lenders have had to extend such loans to 48 months, which reduces the monthy payment by $55, to $222. That's still a pretty good percentage of income going to a car payment.

Although we don't make mortgage loans, our loan applications show an even higher percentage of personal income going to housing. Now mortgage payments on a recently purchased home can run as much as $600 to $800 per month.

Monthly bills like that, plus living expenses, plus credit cards, soon put one beyond their means. And the solution, more and more often, is filing for bankruptcy.

There used to be social stigma attached to bankruptcy that acted as a deterrent. But new Federal laws have changed that. Now we see attorneys on their TV commercials advocating bankruptcy as almost a social good and implying that the slate is simply wiped clean for a fresh start. They don't point out that bankruptcy seriously impairs one's ability to get credit again. And this is a credit society we live in.

In addition, the increased losses of financial institutions due to personal bankruptcies cut even further into their narrowing spreads.

The myriad causes and effects of high interest rates appear to be nearly unmanageable.

Senator, I do not envy your task of trying to formulate legislation to deal with these problems, but I do thank you for providing us with the forum to express our opinions.

Senator **Sarbanes**. Thank you very much for that testimony.

Gentlemen, let me ask the panel this question:

To start with, Mr. Walton, are you losing your depositors in number, or are they simply shifting a large part of what they have with you somewhere else while staying with you in numbers?

Mr. **Walton**. We find they are staying with us in numbers, but the withdrawals are moving out—again, we've just noticed the trend. We've been fortunate, up to this point, that it hasn't hit us harder and sooner.

Senator **Sarbanes**. Mr. Moran.

Mr. **Moran**. We are keeping the customer base. And, in fact, we are actually increasing the number of relationships with customers. But the dollars are going out, to a large extent, to the money market mutual funds.

Senator **Sarbanes**. And Mr. Beasman.

Mr. **Beasman**. The same thing is true. We are increasing our customer base through a variety of services, branching, but losing money over the counter, not to the extent that the industry has been losing it; but we are losing deposits over the counter, although we are remaining profitable and running in the black.

Senator **Sarbanes**. Bob Hecht said, in his prepared statement—and I just want to quote it for a moment—

> Whether implicitly or explicity, housing is no longer a government priority. I can appreciate that priorities can change as the times change. But when we affect an industry that so completely permeats our economy, we cannot tolerate abrupt changes in direction. Housing has not caused the economic problems of today, and housing should not be called upon to carry the weight of solving these complex issues. Housing can and should remain a priority.

Mr. Beasman, as I understood your prepared statement, you said people don't fully appreciate what it means to own a home, and they're just going to have to understand that things are a lot tougher.

Do you think housing can and should remain a priority?

Mr. **Beasman**. For the Government?

Senator **Sarbanes**. As a priority of Government policy?

Mr. **Beasman**. Yes, sir.

I'm not so sure though that it should remain a priority for investors that it has in the past. Until such time as a loan instrument is developed, that is for a residential mortgage loan, that will allow it to compete with the alternative forms of investments that are available in the marketplace, then the mortgage is going to take second place to those alternative forms of investment.

We're looking at money running out of the financial institutions that traditionally have invested in mortgage loans. Why? Not because the customers are disenchanted with the savings institutions or dislike management or fear for their integrity—financial integrity or their viability—for one reason only, we cannot pay the same rate of interest that other institutions can pay, because they have alternative forms of investment where they can put their money. And this is the old business of supply and demand.

And I believe we have to recognize the fact that the person who saves the dollar, the person who makes the capital available is the one in the driver's seat. And that capital will flow to those markets that will provide them the highest return on the dollars.

If those who are making mortgage loans cannot or are unwilling or unable to provide the return that that saver wants, then their money will not flow into those institutions.

Therefore, if housing is important, as I believe it is, then I believe that the Government will have to play a much larger role in providing the financing for those homes. I think we should confront it, we should face that issue, that if there are other users of capital out in the market that are willing or able to pay a much higher rate of return than what a borrower is willing and able to pay, then the Government has got to step in and provide the mechanism to allow people to buy homes. That is so clear. I don't see how we can possibly avoid reaching that conclusion.

And I am one who says, "I think Government should step out of business." But here is an area where I think it is absolutely essential for the welfare of this country, housing.

And if the private individual, the savers, are unwilling to subsidize or pay for it, then Uncle Sam has to do it. And there is nothing wrong with that. It is a question of how the Government finances or subsidzes that mortgage.

They can't do it by debt, which is the problem that has occurred, off balance-sheet borrowing, increasing public debt. But I'm absolutely convinced that Uncle Sam has got to play a much greater role in the providing of housing for individuals.

Senator **Sarbanes**. Of course, if he does in one way or another, it becomes part of the budgetary process. There is no way to do it and hide it.

I must say that it is not my perception that people are unwilling to make sacrifices in order to own a home. It is my perception that the cost now of doing so is just simply beyond their reach.

And was it a 50-percent figure you gave us, Mr. Moran, at the outset in that instance?

What we've been hearing and encountering, is that people are prepared to put more and more of their disposable income into housing. But even doing so, they come up against a situation where they just simply cannot handle the cost. And it all relates to the interest charges. The difference in your monthly carrying charge, depending upon a 12- or a 14-percent rate and an 18-percent rate, is enormously significant. It is the difference between whether they are able to do or not able to do it.

Mr. **Beasman**. That is a portion of the increased cost. Interest is one fact. Taxes is another. Insurance is another. And the cost of the house and the size of the debt is another. And that contributes to the increase in the monthly payments.

But getting back to the point of what portion of income a family is willing to pay for a home, I don't believe we have reached that maximum. All we have to do is go to other countries and see what portion of their incomes go for the acquisition of a home.

Senator **Sarbanes**. That is an interesting point. I'm glad you brought it up, because I really want to say that it is my perception that one of the strengths of our society, as distinct from others, has been our relative success in encouraging and maintaining home ownership, which offers the social benefits of stability, of giving people a sense of equity in the society. For the overwhelming portion of our people, their most significant investment over the course of a lifetime is their home. One of the strengths of this society and one of the sources of its stability, compared with other countries, is that we have been able to do that.

Your point that it is different here than in other countries is well taken. I think that is quite true. I see that difference as the strength of our society and a weakness in those societies, generally speaking. I am quite concerned that we not say, "Well, this is what happened in other countries, and we're going to move in that direction." I don't want to see the Europeanization of America with respect to our attitudes toward housing and home ownership. I think, frankly, that would be moving in the wrong direction.

Mr. **Beasman**. I don't know whether I agree with you fully, Senator.

When we're looking at our country, we are looking at a maturing economy, not a vibrant, young, dynamic economy that was experienced up to, through, and after World War II. We are coming to a mature economy. And the factors that work in a mature economy are far different than that in a young, new, and vibrant economy. The philosophy is different, the people are willing to accept—and they do—accept the change, because they have different thoughts and different appetites than they once had.

As we grow older, as people grow older, our appetites change, our desires for styles and standards of living change. And this is true with an economy.

And therefore, I believe that owning a home, owning a piece of America, is absolutely essential and important to our economy. But I also believe that as our economy matures, our people will be willing to make greater sacrifices for the sake of buying that home.

Now, to say that to the extent that Uncle Sam can step in and accelerate that ownership of homes, fine, they should do it, because I'm absolutely convinced the Federal Government must do it.

But I believe that if we feel that we can continue—our economy can continue on, the way it has from the date of our birth, is a mistake. We have to look to what has happened and to other countries that are much older than ours.

And when they look at our country of 200-and-some-odd years, they say, "My God, you're a baby. We're talking about 2,000- to 3,000-year-old countries."

I think we have to look at what they're experience has been and accept that there may be—it may be inevitable and it might be the right way to go.

That's long-winded, I know. But I feel very strongly about this business of home ownership in the maturing type of economy we have, also the fact that people will do with less in order to acquire their home. There's nothing wrong with that.

Senator **Sarbanes**. Mr. Moran, let me ask you, what is the median-priced house in the Baltimore area? Do you have the figure for that?

Mr. **Moran**. I don't have the figure for the Baltimore area. But if you look across the country right now, it is running about $70,000 or $75,000.

Senator **Sarbanes**. All right. Let's take $75,000. And I come in and I want to buy a house for $75,000. What are the financial circumstances you're going to lay out in front of me?

Mr. **Moran**. Well, it would depend upon your income and what other debts you have. I don't have those ratios with me, but basically we look for your payments not to exceed about 28 or 30 percent of your income.

Mr. **Beasman**. That is up from 22 percent.

A **Voice From Audience**. You're talking about $1,130.32 a month, principal and interest for a 30-year mortgage at 18 percent.

Senator **Sarbanes**. So, on a $75,000 house, you're talking a monthly payment of $1,130 a month?

Mr. **Moran**. That's just principal and interest.

Senator **Sarbanes**. What kind of income would you require of the family to do that?

Mr. **Beasman**. $50,000; but that's also not including a downpayment. That's a 100-percent loan.

Senator **Sarbanes**. So you add taxes and interest and insurance—and you get roughly a $50,000 figure.

Mr. **Beasman**. $50,000 to $60,000—two incomes, $30,000 apiece.

Senator **Sarbanes**. What percentage of American families have that income?

Mr. **Beasman**. As of right not, not as many as there was. They could have afforded a comfortable home 10 years ago.

Senator **Sarbanes**. What percent? I mean, you're talking about the top 10 percent of the income scale.

Mr. **Moran**. At best.

I would say between 5 and 10 percent.

Mr. **Beasman**. No; I think there's a greater proportion of families at that income. I think you're looking at the individual income, per capita income, at $50,000.

Senator **Sarbanes**. Well, the median family income in this country, as I understand it now, is about $20,000 to $21,000. That means half of all families are below that and half are above.

And now we're talking about a $50,000 to $60,000 figure. While I don't have it in front of me, I think probably the 10-percent figure is not far wrong.

In effect, what the situation has done is to exclude 90 percent of the families from access to the opportunity to acquire a median-priced home.

Mr. **Moran**. The part that becomes dangerous in all of this is that if they are qualifying on the basis of two incomes and you're talking about the kind of monthly payments we're talking about here, if one of those incomes is removed, even for a short period of time, because of unemployment or health reasons or whatever the family situation might be, it becomes a very dangerous situation. We see situations like this in our lending division, with increases in real estate owned, and the financial problems that people get into. We try to help them to work out of them over a period of time.

Senator **Sarbanes**. Well, gentlemen, we thank you very much. It's been a very helpful panel, and we appreciate the effort that went into your testimony.

Next, we will hear from Alan Abramson, representing Maryland auto dealers.

STATEMENT OF ALAN ABRAMSON, PRESIDENT, ARCHWAY MOTORS, INC., BALTIMORE, MD.

Mr. **Abramson**. My name is Alan Abramson. I am the president of a Ford Dealership, Archway Motors, Inc.

First, it is a pleasure being here this morning. And I, too, commend you for conducting these hearings and, in particular, for providing a forum for the smaller businessman.

It's nice to know tht someone cares about our problems. Whatever you've heard about the plight of the automobile dealer in Maryland is even more so in Baltimore City.

I am certain survival strategy has been a constant theme of the last few days. Unfortunately, the theme cannot be overemphasized at this time.

During the last year, we have reorganized our company, relocated within the city, and fortunately I am here to talk about it.

Our formula has been to reduce new vehicle inventory by 80 percent, our employees by 50 percent. We have stressed service, parts, and used vehicle sales, a strategy for coping, not necessarily for growing, yet a strategy becoming more prevalent in our market today.

Dealer costs doubled between 1976 and 1979, and they are projected to double again by 1983.

Historically, floor-plan interest, the interest dealers pay on vehicle inventory, was 15 percent of total new vehicle expense. And total new vehicle expense was traditionally 50 percent of new vehicle gross.

However, during 1980, floor-plan interest rose to 60 percent and more of vehicle expense, and in some months even exceeded the total new vehicle gross. It has moderated somewhat in 1981, primarily because of lower inventory levels.

But keep in mind floor-plan interest is just one of eleven vehicle cost accounts. Approximately 90 percent of the metropolitan Baltimore Ford dealers lost money in 1980. In 1981, we have 15 percent fewer Ford dealers in Baltimore, and 40 percent are unprofitable year to date.

Even this perverse improvement is illusory. Capital was depleted during the 1979–80 period. Dealers are more vulnerable today than ever. And the trending is poor, especially for the short term.

Moreover, the retail finance market is in a shambles. The so-called captives, Ford Motor Credit Co., General Motors Acceptance Corp., and Chrysler Credit have increased their retail market share reluctantly, from about 25 percent of market to 55 percent, and going up; whereas the independents have declined, from 60 percent to 30 percent, and going down.

Thus, less competition means higher costs for consumers and, most importantly, less money available for consumer credit. Particularly as greater borrowing demands are made on the captives, the marginal buyer has disappeared.

After watching TV last Sunday, I would say economists have gained parity with evangelists for program dominance. [Laughter.]

Charles Schultze was followed by Paul Volcker, who was followed by Murray Weidenbaum.

Chairman Volcker is committed to crushing inflationary expectation even if it means sustaining or raising current interest rates.

Mr. Volcker raises a specter of recession as a likelihood if he were to relent in regard to the Federal Reserve's tight-fisted monetary policy. My God, doesn't he realize that our business has been in a deep recession for more than 2 years? Somehow he clings to the fiction of a statistical, nonrecessionary equilibrium in our economy.

We are paying more than our fair share of the dues. There can be no growth in our industry as long as interest rates remain high unless we have runaway inflation.

Thus, the Feds' one-dimensional policy of controlling the money supply, primarily by sustaining high interest rates, has the opposite effect in our business. It fuels inflation.

Chairman Volcker conceded the auto industry is on the whip end of the economic crunch. The auto dealer, then, is on the whip end of the whip end, if you will.

The auto manufacturers have stood classical economics on its head. As demand diminishes, they increase prices.

We must break out of the wage-material cost of money-price spiral. The current situation reminds me of the medieval king, who, upon receiving bad news, kills the messenger.

In a sense, all of us here today are messengers, Senator. Keep them from killing us.

Senator **Sarbanes**. Thank you for a very strong statement. I really have no questions. We appreciate the depth of thought and feeling that went into that statement. Thank you very much.

Mr. **Abramson**. Thank you.

Senator **Sarbanes**. If we could have our small business panel, Ron Fradkin, Bill Streuver, Leslie Lewis, and Bill Pacy. Gentlemen, do you have any preferred order among yourselves as to how you want to proceed? I will leave that up to you.

Mr. Fradkin, why don't you go ahead.

STATEMENT OF RONALD FRADKIN, PRESIDENT, AL FRADKIN CO., BALTIMORE, MD., REPRESENTING THE MARYLAND HOME FURNISHINGS ASSOCIATION

Mr. **Fradkin**. Senator, I am Ronald Fradkin, president of the Al Fradkin Co., of downtown Baltimore. I am a past president of the Furniture Retailers Association of the State of Maryland, and chairman of the board of that group. And I was just invited to this session last night, so I am filling in for our president, Gerald Jeffein, who was suddenly hospitalized.

I represent the Maryland Home Furnishings Association, and it is important to note that this economic situation affects our business in many ways. I am going to address myself this morning primarily to the consumer credit aspect of it, which seems to be the most critical. Mr. Abramson did an admirable job from the automobile viewpoint, and ours is very similar.

Seventy-five percent of home furnishings are sold on credit. About half of our members finance their own accounts, and the others sell their paper to finance companies, such as Household, Beneficial, and others. The maximum rate on credit sales allowed by the State of Maryland is 22 percent on amounts up to $1,000, and 18 percent on any amount over $1,000.

Our member stores are paying from 2 to 5 points over prime for money that they borrow from the banks. And we calculate that the costs of operating a credit department is about 9 percent.

May I just hand you a photostat of an interest bill from Maryland National Bank as presented to one of our members, showing their rate being 2½ percent over prime, and that is just from, I think, last month. That is fairly typical. You can see that due to the cost of money, we are being asked to extend credit at less than our cost, less than our absolute cost, for the funds, let alone the risk factor that we take, which may vary from 1 to 5 percent for an individual business; and the cost of personnel, office space, and so forth.

As a result, stores are either closing or severely restricting their extension of credit. The lower-income segment of our population, those who relay on credit the most for necessities, are just about being eliminated from the credit market. I can tell you that in our own company we went from a policy of several years ago of granting up to 36 months' repayment time to a policy today of 18 months—half of that—which makes it very difficult for people to buy.

To the extent possible, some of our members are raising prices to cover their cost of credit. This means that the cash customer subsidizes the credit customer, and the short-term credit customer, who pays a little bit of interest, is subsidizing the long-term credit customer. And this is not how the marketplace should work.

We advised Chairman Volcker of the Federal Reserve Board of this situation, and in his response, he agreed that this distortion is taking place. We feel that the Federal Government created this distortion by imposing these high interest rates and that it should therefore resolve the problem by overriding State usury laws.

We ask you to support Senate bill 1406, which accomplishes this purpose. I refer again to Mr. Volcker's letter, in which he says: "The board has repeatedly stated that State usury ceilings distort credit flows, and has encouraged States to repeal them." I understand that Maryland is one of the few States in the country that has not done that to date.

Now, for the stores that sell their paper to finance companies, the problem is also very bad. The finance companies are closing one by one, either going out of business or going out of Maryland to

States where they can have a more advantageous position. Many that remain are not opening new accounts, and the few that are accepting business are just about eliminating low-income families, again, from their portfolios.

The larger stores that are able to get better financing are holding on, while smaller stores are being driven out of business. The Federal Truth-in-Lending Act, regulation Z, which is supposed to protect the consumer by advising him of the true cost of credit, is having just the opposite effect, since the stores are forced to hide the cost of credit in the price.

Mr. Volcker states that since interest costs are a deductible expense, that part of the cost is borne by the Federal Government. What he doesn't state is that this is only true if the company is profitable. With the high interest rates today, many of our members are losing money, and therefore they bear the total cost of interest themselves.

We realize that this inflation is a terrible problem in our economy, and we are willing to tighten our belts and do whatever we can to help, as suggested by Mr. Volcker. However, it appears that if these high interest rates continue and the laws are not changed, many of us will be forced out of business, with the concommitant ill effects to our economy and to our people.

We thank you for your attention and for your help in this matter.

Senator SARBANES. Thank you.

Mr. Lewis, please proceed.

STATEMENT OF LESLIE L. LEWIS, JR., PRESIDENT, LEWIS FINANCIAL, BALTIMORE, MD.

Mr. LEWIS. Senator, my name is Les Lewis. I am president of a financial consulting firm, Lewis Financial, and my background is basically in banking. I was in the banking business as a commercial lender for 10 years. My statement is in longhand, and will be presented to you before the day's end. What I would like to speak about, primarily, is the impact of high interest rates on small business as it pertains to the availability of credit, and principally the availability of credit from commercial banks.

In Baltimore, and particularly in Maryland, there is not an organization in business for the specific purposes of providing credit for new business and for existing businesses which are considered small and/or minority. Most businesses in this area which need conventional financing must pursue that financing through the conventional commercial banking network.

In the past 10 years there has been a significant change in the mix of core deposits at commercial banks in this area. Specifically, there has been a tremendous emphasis on the significance of short-term certificates of deposit, which are necessary because of the impending disintermediation in savings deposits at commercial banks.

There are many thrift institutions, savings and loans, and money market programs available for investors. Most of the commercial banks have lost significant core deposits in the savings area. These deposits were the basis for many loans to small businesses. And now that those deposits are absent, the short-term and small loans to businesses must be funded by CD's or certificates of deposits, if you will. Because of the high interest rates—and particularly because the price of certificates of deposits follow the prime rate, and other short-term market instruments—the cost to banks has increased significantly, as has the prime rate.

Usually we attach a spread between certificates of deposit and the prime of about 2½ to 3 points. And I will use that as an example in this instance. The prime rate, if you follow the history from 1973 through today's date, has moved from an average of 7¾ percent in 1973 to a low of 6¾ percent in 1976, to today's rate of 20 percent. And the average this year is going to be in the high double digits, probably 19½ to 20 percent.

What happens in the commercial banking business when the cost of deposit increases to those levels is that there is credit restraint placed on certain types of assets. The first asset which in normally the recipient of such credit restraint is the loans to small businesses, particularly because when banks are funding loans with short-term volatile deposits which have high cost, they must make sure that the assets in which they deposit those funds are quality assets, and assets which will reap a return of both principal and interest.

Credit restraint on small business for the period 1974, when the prime reached its first double-digit peak of 12 percent—it occurred to the extent that all the Baltimore banks removed themselves from that market, and it was a public statement to that effect. In 1979 through 1981, we have not heard a public statement to that effect; however, the reality of the marketplace is that small businesses have an extremely difficult time obtaining credit in this market.

I am fortunate to chair the Loan Committee of the only two small business lending groups in this area, and the demand for credit from businesses which heretofore had been deemed bankable businesses in extremely high. The high interest rates also puts significant pressure on these businesses, when they are able to acquire bank credit today.

Since core deposits or savings deposits, which typically have fixed rates, are absent today from commercial banks, most companies which are able to acquire credit have to acquire the credit on a floating rate basis at a premium over prime of 2 to 5 points—as was mentioned earlier.

For a business to make 2 percent of business plan for long-term credit on a floating rate basis, a small business, is a very difficult thing to do, because it is difficult to project those businesses which in fact did obtain bank credit in 1979, when the prime rate averaged approximately 15 percent, and are experiencing a prime rate today of 20 percent, are paying 7 to 8 points in addition on pure interest costs, which were not projected. And that is the principal reason why many of these businesses have failed.

Business failures and bankruptcies are up. As a matter of fact, the statistic from Dun & Bradstreet which relates to business failures only relates to the number of businesses that have filed bankruptcy; they don't include businesses wherein the proprietor has simply walked away from the business, or has removed himself without filing bankruptcy.

The added assistance to commercial banks as an incentive to make loans to small business, namely the SBA guarantee, does not in any way solve the problem of high interest rates and borrowing costs. As a matter of fact, the guarantee is an instrument that is used when the SBA adopts a policy of pegging their interest rate to the New York prime at no less than 2¾ percent floating above the prime rate. That is an exceedingly high rate in today's market.

The other areas of concern, as it relates to high interest rates—and I will just mention one area of concern—is the shift in consumer assistance. Many small business people and individuals who seek consumer credit from commercial banks, and are considered good credit risks typically are not able to receive the credit during the high interest period, because of the State usury laws. We have an 18 percent imposed usury ceiling here for personal loans and consumer loans.

And when a bank is paying an average cost for certificates of deposit of 17 percent, they impose credit restraint on those portfolios as well. Those customers either have to take a self-imposed period of restraint in terms of borrowing that money or they must go to a finance company, where the cost of borrowing is typically higher. For small loan companies in this area, interest rates can be charged as high as 36 percent.

The final area of concern I would like to mention is the quality of life consideration for people who have started small businesses and who can't get credit because of high rates, and how the quality of life is definitely exposed, via rising prime rates in this area, and other considerations. And I would just like to make a final note that high interest rates really do visibly show the need for alternative mechanisms of financing in this area.

As I have mentioned, we don't have a small business investment corporation which specializes in small business lending. We don't have any bank in this area that has an urban affairs division within the bank that specializes in lending to minorities and small businesses. And we don't have a minority-controlled bank in the area, which would not offer any advantage in terms of providing loans at different rates but would offer a degree of sensitivity and access to people who ordinarily can't get credit.

That is my statement, and I will certainly see to it that you get a hard copy. Thank you.

Senator SARBANES. Thank you very much.

Mr. Struver.

STATEMENT OF WILLIAM STRUVER, STRUVER BROS. & ECCLES, BALTIMORE, MD.

Mr. STRUVER. Mr name is Bill Struver, and I am a small general contractor and developer in Baltimore, and I am chairman of the Economic Development Committee of the Private Industry Council on the Planning Council of the Greater Baltimore Comittee, and a member of the mayor's Baltimore City Small Business Advisory Committee.

It is with some delight that I noticed that even our normally jovial and coolheaded President lost his temper past week, and lashed out at the Federal Reserve for squeezing the money supply so tight that interest rates remained at near-record highs. His wonderful new economic plan, which he had just signed into law, was already disrupted by the unexpectedly high cost of the Government borrowing money, and thus threatening a far greater budget deficit than projected.

The 15-percent interest rate on Treasury bills forced the President to take the enbarrassing step of either finding new tax revenues—after just signing the biggest tax cut in history—or reducing defense spending, which he said was sacrosanct; or accepting a mushrooming budget deficit, which he insisted was out of the question. That's a tough spot to be in.

And perhaps in some small way President Reagan, when he lost his temper, was feeling the disruption so pervasive among Americans today that are trying to borrow money to buy or sell a home, expand a factory and buy new equipment, or to pay tuition, or to open a new restaurant. Perhaps the President understood that even with $750 billion in tax cuts, the boom in private business investment that was critical to his economic strategy would be stillborn, because business couldn't afford the cost of funds to make the investment.

If the President is truly angered by high interest rates, then I say, "Hooray," for he has discovered a root cause of inflation and a stagnant economy. For it is the irony of the Federal Reserve's battle to control inflation that their chief weapon, high interest rates, is in truth their greatest enemy.

The high cost of capital sucks vitality from businesses and adds to the cost of production. As a developer, I see the same $50,000 house I renovated 2 years ago, that cost a buyer with a 10-percent-interest mortgage $450 a month for principal and interest, that now costs $740 a month, with 17½-interest. An old, abandoned school building on Howard Street that I could convert into grand, high-ceilinged apartments and rent to young downtown office workers for $400 a month, now I would have to rent for $650 a month just to pay the mortgage.

When rehabilitating a once elegant Charles Street office building, I am faced with a choice of, when we are doing our pro formas and sitting down with the bank and trying to figure out how to borrow the money and how to make it work—and that's what you have to do when you sit down with bankers—if you are faced with a choice, right there on the paper, of either raising office rents and convincing the banks that people will pay the higher rents, 30 percent over the market, or spending 40 percent less on air-conditioning, better carpeting, light fixtures, trim work, solid improvements that go into making that a great building—just because of the increasing commercial interest rates, from 12 percent to 17 percent.

Even 17 percent is a tax-exempt interest rate. That is with the industrial revenue bonds. I must either charge my customers more for the same product, or give them a smaller product for the same money. Manufacturer and farmer, likewise, must pass the cost through to the customer. The added cost of borrowing money, however, is only the beginning of the damage inflicted by higher interest rates on our economy, and that is what Les Lewis is talking about.

Availability of financing is essential to business growth, and as interest rates go up, loans become harder to get, particularly for new and small businesses that are high credit risks.

And the President, like everybody else, has read the Birch report, and knows that small business—in the Birch study of 5.6 million businesses—small businesses with fewer than 20 employees, create two-thirds of the Nation's net new employment. And if you look at the Northeastern part of the United States, where all of the older cities are, small business accounts for virtually all of the net new employment.

So us little guys are very important in the big picture. And as a developer who has gone with potential store owners, who want to go into places like Charles Street—and a lot of banks in town are very sympathetic, even though they often don't have the funds available—and I agree with Les Lewis, it is a real problem in terms of accessibility.

We have found that it is not out of spite, or out of sympathy for the needs of small business, minority-owned businesses, but you go to bank after bank, get a very sympathetic hearing, and you find that getting a startup loan is tough. It is not only dispiriting—the process of going around like that and putting your whole enthusiastic sales pitch into why this is going to be a great restaurant or great business—but it turns out it is a really futile effort.

Yet most economists agree that it is precisely these small guys that we really need to count on to generate the growth that the President is counting on to make his economic projections work. With a decidedly poor sense of timing, the administration chooses at this moment to eliminate or drastically reduce virtually all Federal efforts to target financing assistance to new and small business—EDA, UDAG, 312, SBA 502 plus 503, GNMA—it's all numbers and acronyms, programs that are the lifeblood that made Baltimore's revitalization what it is today.

You add onto that—Congress recently passed legislation that curbed the authority of local jurisdictions to provide tax-exempt, low-interest financing for housing a commercial projects. Baltimore got in with its $100 million bond issue for home loans just under the wire.

Senator **Sarbanes**. That wasn't easy to do, I'll tell you.

Mr. **Struver**. That wasn't easy to do. There was a lot of help from you guys, I guess. The legislation introduced, coming up, is even worse. They are talking about completely eliminating the industrial revenue bonds for 1984.

You add onto that municipal bonds in cities like Baltimore, which provided REAL loans, and the "Shopsteading" loans that Janet Hoffman talked about, and you add section 8 projects—we're doing Ridgly's Delight as a section 8 project for people that have been displaced by the renovations. These programs are getting squeezed, because first they're used to leverage private money, and they have to put up more money to get the same amount of results; and at the same time, it's getting to the point—I noticed on a sheet of bond rates from New York, CD rates and the like, they weren't even quoting municipal bond rates. "NA," they had, "not available." So it is obviously becoming harder, for the cities to do the excellent job that it has ever since Nixon wiped out Federal housing programs in 1972, temporarily, and Baltimore came in and acted to help itself as a local jurisdiction, establishing its own financing programs.

So we are losing the Federal help. We are losing the local ability to help itself and the private guys and, the private bankers are in a jam—so in place of these programs that are targeted to areas and businesses of particular need, the President is offering the largest tax cuts in this Nation's history. The cuts come in the form of major reductions in upper income tax rates. The maxi-tax. A flood of investment tax credits and accelerated depreciation.

Unfortunately, new and small businesses have little use for these tax breaks. If you don't make money, you don't pay taxes. What they need is financing, long-term financing, to build and equip factories, and short-term financing so we can make our payroll on Fridays and pay our suppliers at the end of the month—or by the 10th of the month afterward, if they are nice to us.

What we are seeing, with the combination of high interest rates, and when you add onto that the whole picture of what the President's program is—which is reduced public sector financing, and direct economic development aid—EDA, UDAG, CETA—you add onto that the big tax cuts—you have got a massive distribution of resources going on.

Tax cuts will increase the profitability of already profitable companies, perhaps, but may make traditional tax incentives, such as tax-exempt industrial revenue bonds—even if they are still around—municipal bonds, and accelerated depreciation of low-income housing no longer attractive investments. And I can guarantee you, without the accelerated depreciation breaks that they have for low-income housing, there wouldn't be any section 8 housing built today.

We've finally got the targeted tax incentive for historic renovation which helps cities, as compared to the investment tax credit for new construction that has encouraged all businesses to leave town. So for once we are starting to get the Tax Code to try to target some of this help to the place that needs help, the place that needs jobs, and one big fear I have is that the new tax bill is so massive and so dramatically changes around the whole picture of who pays taxes—are corporations going to pay any taxes at all? Are the people that used to be in the upper income brackets that really like these types of tax shelters and would take these high risks, low-income housing projects, are they going to be around? Or are our tax rates going to be so low that who cares?

What's going to happen is that in the competition for investment—that is what we're talking about, Baltimore Federal Savings and Loan and The Savings Bank of Baltimore, we're all talking about competing for those dollars—distressed urban areas lose out. I note that Baltimore Federal and The Savings Bank, too, these people that really have been committed to helping Baltimore get started and have done their level best to be a part of this whole partnership of the city and private lenders and small businesses and community working together to get something going in this town. They have tried to help the city, and they are losing in this competition for funds.

It is just being sucked out by the billions at record rates, funds are going out of the savings accounts this spring and summer.

Why invest in a small business, when you can buy a Treasury note for 15 percent or get one of those money market funds? Why put your money in a savings account with Baltimore Federal, even though they do all of these great things for Baltimore, when you can get 18 percent from Merrill Lynch? I don't know what they do with their money, but I haven't seen Merrill Lynch making mortgages in Baltimore.

Cuts in the public sector financing and direct economic development assistance hit the growth business; we're all getting nailed from the high interest rates; additional cuts in other programs made to offset the loss in tax revenues reduce desperately needed services for minorities, the poor, the sick and disabled.

The mayor is estimating $350 million loss of purchasing power in Baltimore next year using a two times multiplier on the budget cuts and loss of Federal funds. And if you start thinking about what that is going to do to our stores and trying to sell home furnishings or cars, as the loss of that money trickles down, it is going to affect us all.

And worse of all, the unemployed already impacted in cities like Baltimore will lose the opportunity to help themselves with billions of dollars in Federal assistance for job training, day care, housing, all of the programs that help them to get back to work are slashed. Opportunity is the bottom line in our society, opportunity to get good education, learn new job skills, start a new business, buy a house.

I agree with you about the home being a stake in our society, having some equity in it. We are trying to accomplish this with the Ridgly's Delight section 8 project. We are fighting against the problems of the tax incentives requiring the investors to keep the ownership so as to give something to the tenants, so that they have some control over it and have a long-term investment, and so that they can look down the road that this is going to be their housing. This is something that I think is important to work out.

So that is opportunity. Opportunity to get a good job, so that a worker can help himself. I would put that number one above owning a home, having a good job, because then a worker can help himself and help his family to everything else. That is the most effective way. That is the efficient way. That is the "American Way."

Yet Baltimore faces the bitterly contradictory position of having 75,000 substandard housing units, one-half of the rental market, in need of renovation, while at the same time the city has 42,000 people out of work. Unemployment rates in the construction industry probably run 30 percent.

The minority unemployment rate? Take a stab. Minority youth unemployment rates are so high you can't even measure. Because of the way they define it, it is meaningless now. With all those people out of work, many of them could be productively employed. Just using one little example in construction. Improving living conditions. Making this place a better place to live and raising living standards without adding to the inflation. By putting people to work, getting them off unemployment, putting them back to work productively. Making Baltimore a better place to live.

So we are stuck between this rock and a hard place with no money to take care of that housing. You've got all the housing needs and all the people need work, but you can't do it. It's just sitting there.

Janet Hoffman gave the example of the developer who has got that project over in East Baltimore, 99 housing units. He's been working on it for 3 years. UDAG, city loans, and this and that. Trying to pull everything together. And it became a very discouraging story. He wants out; a big developer, and yet it just won't work.

High interest rates and President Reagan's economic program taken together force a disproportionate burden upon the unemployed and the underprivileged. President Reagan's economic strategy comes down with an iron fist upon this opportunity that we're talking about.

Without hope for progress, racial strife could bring chaos to Baltimore. Without opportunity, there's only despair and frustration and that threatens the very foundation of our society.

So there is a lot that needs to be done.

Thank you.

Senator SARBANES. Thank you very much for a very perceptive and thoughtful statement.

Mr. Collins.

STATEMENT OF JEROME A. COLLINS, MARKET CENTER DEVELOPMENT CORP. OF BALTIMORE, BALTIMORE, MD.

Mr. COLLINS. Thank you, Senator Sarbanes. My name is Jerome Collins of the Market Center Development Corp. of Baltimore. bill Pacy, who coauthored the prepared statement, wants you to know he's sorry he couldn't be here, but he is trying to do something else to help the community.

And those of us at Market Center are pleased that you have been conducting these hearings, because I think our input would be somewhat different from what has been stated, and yet reflective of all the remarks to date.

What I am going to say is a generalization, perhaps, but includes what we believe to be terribly important for the area in which we work. This Market Center group is a quasi-public, nonprofit corporation under contract to the mayor and the city of Baltimore involved in traditional downtown areas, the retail district, and on some 82 acres. Our original purpose came about through an urban initiative, joint development Value Capture Site grant matched by the city of $2.5 million to develop three joint development sites, the principal one being in the heart of downtown.

This site, which is on Howard Street, Lexington and Eutaw, is the anchor—will be the anchor for whatever is produced. Now to be a success in our urban renewal efforts in the city and rehabilitation plans for the 82 acres, we must maintain and enhance the necessary economic and social equilibrium. In today's money market, this is just simply not possible.

Let me give you three small examples. In this core area, many developers, building among them, national and even international have expressed considerable interest, but the high cost of money just keeps them away. Fortunately, we do have a developer of national importance who is using his own money for a very significant project, but he is the exception.

In 1979, a large gathering of merchants and property owners from within the district agreed, voted unanimously for mandatory property rehabilitation standards, and these would uplift the area in many ways. They would make it look better. They would create a new spirit. But most of all, as Bill has observed and others have, they produce jobs, very much needed jobs. Mrs. Hoffman certainly emphasized that as a major concern of the city and the mayor. But we are having trouble helping these folks, because the high interest rates, the financing, just makes it impossible for them to proceed.

There are about 600 properties in the district. Thirty of these properties are completed in terms of their facade or rehabilitation and are underway. And although some people think this is a significant increase in terms of when these are supposed to be completed, it just won't happen. And the reason is, they can't get the money to do the job.

Another illustration, last year the Social Security Administration opened a 1 million plus square foot office building in this area. Now that is a tremendous investment of public dollars, but even now the area around this beautiful building complex is deteriorating. The folks in that area would love to go ahead with their rehabilitation and do needed repairs. They can't. They just can't get the money.

So interest rates are blocking progress in this vital urban renewal program of 82 acres in the heart of Baltimore City. And the heart of the community must be vibrant or all will gradually fall into decay. We have to gain relief, and without these financial adjustments, the necessary economic and social progress will falter and it could fail. And this would be a community disaster.

Baltimore is a national leader, the national leader, may say, in answering the challenges of urban life. We are talking here about jobs. Jobs create dignity. And this, in our belief, is the bottom line. This must happen. We could provide far more jobs immediately through construction. We in turn could create jobs with new business, with small business. And we're talking about a really small business. We're talking about mom-and-pop places. And that is the backbone of America, in our opinion. If we are to continue the success that has been generated in this community, then these interest rates, this inflation some how must be abated.

Let's say it another way. The public moneys, our tax dollars, invested in the retail district urban renewal area now exceeds some $1 billion with more to come; $1 billion if you include, Senator, the subway, the headquarters for the subway, and the fact that this new subway is predicated on this notion of the urban initiatives and the Value Capture Sites. The community goal here is to achieve maximum impact from this transfusion of Federal and city dollars.

The theory of public investment is to provide incentivies for private investors. The theory which has become dramatic reality in Baltimore. In turn, these investments of public and private resources are supportive of business and activities which maintain and produce jobs. Tragically, large and small business can no longer transform this urban initiative theory into vital practice. It costs too much.

To survive, therefore, business people and property owners in our district must have immediate interest rate relief. Otherwise, these businesses and these buildings will lose vitality and surely, painfully, succumb to the inflationary virus which now infects them.

Thank you, Senator

[The prepared statement of Mr. Collins follows:]

Prepared Statement of Jerome A. Collins

As an officer of Market Center Development Corporation of Baltimore, I am pleased that our organization can participate in this hearing, arranged by Senator Sarbanes.

The subjects outlined by the Senator—investment, jobs and prices—are of vital concern to MCDC. This organization is a quasi-public, non-profit group under contract to the Mayor and City Council of Baltimore.

Our principal purpose is the development of three major opportunity sites within the boundaries of the City. These so called Joint Development/Value Capture Sites were made possible by a ten million dollar Urban Initiatives Grant of the Urban Mass Transportation Administration, matched by a 2.5 million dollar city investment.

One of these sites is located so as to provide an anchor position in the heart of an area in which more than one billion dollars in public monies has been invested (if one includes the Lexington Market subway terminal and Maryland Transportation Administration headquarters). More substantial city funds are to be invested.

The city's urban renewal and rehabilitation plans must be a total success if the community is to maintain and enhance the necessary economic and social equilibrium for this core area. In today's money market, this degree of success is simply not possible. Let us explain why.

1. Many developers of regional, national and international reputation have expressed interest in various sites, particularly the Value Capture Sites downtown. The high cost of money has kept them from moving forward.

2. In late 1979, a large gathering of merchants and property owners from within the District voted unanimously for mandatory property rehabilitation standards. These are now in force by law. But the people who wanted to reface their facades and do other necessary work to enhance the appearance of their buildings and, there, increase the value of their properties, find they cannot get the financing at reasonable rates.

This important project needs help in the way of affordable money. Only 30 properties are completed or under way out of the 600 in the District.

The deadline for compliance on major streets is July 1982. Properties on other streets must be renewed by July, 1984. As Mayor Schaefer has observed, in addition to enhancing the appearance of the area, this project would provide new jobs and wages.

3. The Social Security Administration opened a one million plus square foot office building called Metro West within the District last year. Already there are complaints concerning the deterioration of the surrounding area. Baltimore City attempts to upgrade this area through property rehabilitation standards are stymied because the small merchants and small business people within the District cannot get the affordable financing necessary to proceed with needed change.

This could mean that the investment by the Federal and City Governments—our tax dollars—is in jeopardy. To build multi-million dollar office complex like Metro West in a neighborhood going down would be poor investment policy. With an affordable money pool, SSA neighbors would upgrade their places of business and their buildings. They want to do so.

Members of the Joint Economic Committee: Interest rates are blocking progress in this vital urban renewal program of 82 acres in the heart of Baltimore City. We must gain relief. Without this financial adjustment, necessary economic and social progress, will falter—could fail. This would be a community disaster.

Baltimore is a national leader—the national leader, many say—in answering the challenges of urban life. We are talking here about jobs, and dignity. We believe an adjustment to high interest rates is an absolute must if we are to continue the success we have generated to this date.

Let us say it another way. The public monies—our tax dollars—invested in the Retail District Urban Renewal Area of Baltimore City now exceeds some one billion dollars with more investment slated for the area.

The Community goal here is to achieve maximum impact from this transfusion of Federal and City dollars. But there is a real and present danger that this will not be possible because of the unbridled surge of interest rates—the cost of money.

The theory of public investment is to provide incentives for private investment, a theory which has become dramatic reality in Baltimore City. In turn, these investments of public and private resources are supportive of business and activities which maintain and produce jobs.

Tragically, large and small business can no longer transform this urban initiative theory into vital practice. It costs too much. To survive, therefore, business people and property owners in our District must have immediate interest-rate relief. Otherwise, these businesses, and these buildings will lose vitality and surely, painfully succumb to the inflationary virus which now infects them.

Senator **Sarbanes**. Well, gentleman, I want to thank all four of you for very perceptive and thoughtful statements and I have just a few questions, but I think the sense of community responsibility that was reflected in your statements as small business people in this community is a dramatic example of what has helped to contribute to the research and the renaissance that has taken place in Baltimore and which has attracted such national attention.

And I think to come in here as business people and to talk not only about your own particular problem, as you see it, and your ability to function, but to put that in the context, as all four of you have done, of the strength of the community and the efforts to improve and better the community, reflects an attitude which I think marks a good deal of the business community in this town, and which I think has been important to what the city has been able to accomplish.

Let me ask you this question: The studies have generally shown that small business is very heavily dependent on debt financing in order to carry on their activities, and I assume that is the situation here as well. I mean, we don't depart from that sort of national standard in any way, do we?

Mr. **Lewis**. Let me make a comment on that, if I may, because that is what I do for a living. I am an investment adviser that helps people with tax shelters, and one of the things that I have been able to do is to have people invest in small businesses which have some history of operating losses and use that as a form of a shelter, but a business that has some potential, so if it works out it is a good investment. In Baltimore we don't have any type of equity assistance program. The brokerage firms are beginning to study the possibilities of doing some type of investment which consists of venture capital. That is investment for new and small businesses.

We don't have any individuals who run companies that invest in small businesses, and we don't have any organizations trying to do that. If we had a MSBIC—if we did have a MSBIC, and MSBIC's are chartered to provide both debt and equity, perhaps we could make a start and make a dent in that area. The only form of financing we have ever had in this area for small businesses which sort of smacks of some sort of equity, in terms of its interest cost, is the direct loan financing from the SBA, which heretofore had provided loans with interest rates from 6 to 9 percent, but that has been pretty much been cut out in this area during this administration.

Senator **Sarbanes**. Mr. Collins, there is a point that Mr. Struver made which I think is important, and that is when you are dealing with bringing back an older city, which is what we are dealing with here, a great deal of effort has to go into putting together the program that is going to work in each particular instance. You referred to the work that you are doing with Market Center and your effort to relate it to the Social Security Complex. Mr. Struver talked about Washington Hill, where they had to stop their efforts. I would just observe that there is a failure to understand that that is a very special problem we confront different from problems in a newer area, where it is simply a matter of expansion. You can stay as you are, or expand. Our situation is that different unless we move forward.

Let me ask you the question. If we don't move forward, are we, in effect, going to fall back? Is this a situation that will simply hold steady, or is it a situation where you have to put the pieces together and move forward out of your situation, or risk falling back into difficult situations?

Mr. **Collins**. Senator, you are absolutely right. For the past 14 or 15 years I've been a consultant with national clients in various aspects of urban renewal, and I came back here because this is my home State, and I'm very pleased to be back here.

Senator **Sarbanes**. We're pleased to have you back.

Mr. **Collins**. It is never a holding situation. It is a situation in these older cities, wherein you must move forward, even to stay even, if you will pardon the pun. Every day you must set an immediate goal in terms of bricks and mortar, I say, and street improvements, and all of these things, to keep abreast, but more important to move forward. You can move forward if the situation is helpful and possible, and right now it isn't. It is just not, and I think Mrs. Hoffman certainly reflecting Mayor Schaefer's beliefs is well aware that without the programs which have been outlined here by many, we can't do this.

So I would say to you, you can't stand still. If you stand still, you are going backward. Just like a good football team.

Mr. **Struver**. I have to say that one of the great achievements of our famous mayor is the confidence that he has built in the city of Baltimore, and that is really the bottom line of what this whole renaissance revitalization is all about that Jim Rouse talks about and Time magazine talks about. The city still faces monstrous problems in unemployment. We talked about that. And crime, housing. It is a mess. There are big, big problems out there, and what has held the city together is this spirit of momentum that things are going to get better, it's going to be a better place to live. It's going to be a better place to work. It's going to be a more fun place to be, a more exciting place to be. A safer place. A good place to make an investment.

And if that spirit of confidence that this city is going ahead breaks down, and all of those problems are just sitting there, it's all going to fall apart. And if the mayor has—and he has tremendous energy, but if it does fall apart, trying to put it back together, that confidence among everybody, among the bankers, among developers, among storeowners, among homeowners, among everybody, is going to be so much harder to put together again.

So we just can't afford to lose it. We are playing with fire. The President is playing with fire. He is playing a very dangerous game, and I, for God's sake, wish him good luck, because if it doesn't work——

Senator **Sarbanes**. Gentlemen, thank you very much. You've been a very helpful panel, and we appreciate it.

Next we will hear from Thomas Bradley, the president of the Maryland State AFL-CIO, and Mr. George Bowler, representing the United Auto Workers.

Mr. Bradley if you would proceed, I think we are ready to hear from you.

STATEMENT OF THOMAS M. BRADLEY, PRESIDENT, MARYLAND STATE-DISTRICT OF COLUMBIA AFL-CIO, ANNAPOLIS, MD.

Mr. **Bradley**. Senator Sarbanes, let me first congratulate you for taking your time out from your tremendous schedule to put these hearings across and have these hearing across the State.

It is vitally important that people have an opportunity to speak. And, Senator, this is certainly just a reflection of what you've been doing in the past.

The Maryland State-District of Columbia—on high interest rates—the American economy today suffers from high unemployment, continuing inflation, and sky-high interest rates.

Today, it is being treated as an economic prescription that ignores that ailings, and instead scutts social programs and shifts income to big, multinational corporations and the wealthy.

The Maryland State-District of Columbia AFL-CIO vehemently opposes double-digit interest rates and labels them as counterproductive. There is no doubt in our minds that is exactly what the high interest imposed by the Federal Reserve Board are, counterproductive.

The Reagan administration economic policies will not solve the Nation's ills; they will put more people out of work; they will aggravate inflation and will bring greater inequity and unfairness to the American economy.

What do these policies add up to, simply, but class warfare against the poor and the working people of America. The battle for inflation should be fought by reducing rather then pushing up the high interest rates that choke the economy.

Interest rates add to the cost of everything, but double-digit interest rates causes exceptional hardship for small business, homeowners, consumers. Unlike multinational corporations and banks, they do not have the ability to shop for credit from the far corners of the world. High interest rates and tight money increase unemployment, reduce government revenues, and increase the cost of social programs.

American workers are now losing jobs, and American families are losing buying power as a result of the depressing effect of the misdirected tight money and tight interest policies.

Exorbitant interest rates have created a depression in the housing industry, made needed investment in industrial modernization too costly, and sent capital scurrying to high-risk, high-profit speculation.

On top of all of this, interest rate payments on the Federal debt have been the fastest rising item in the Federal budget.

The Maryland State-District of Columbia AFL-CIO wishes to go on record in reaffirming the proposals of the national AFL-CIO, that being:

Strengthening and making the Permanent Credit Control Act in order to channel available credit to high-priority areas and to discourage excessive speculation;

Giving the President the authority to restrict U.S. capital abroad and curb extension of credit to foreign ventures whenever it is deemed necessary to increase investment in domestic plants and equipment;

Amending the Federal Reserve Act to enlarge the Board of Governors to include representatives from industry and labor and agriculture and consumers, and not a closed-shop operation for bankers and money-interest people;

Encourage investments of pension funds in long-term, fixed-payment mortgages to help more families purchase housing.

The Reagan administration's Federal Reserve monetary policies must be changed.

In a democratic society, money supply and interest rates and credit policies must serve the needs of the society. This Nation must turn away from disastrous reliance on tight money and high interest rates to fight inflation.

We feel these proposals will be a step in the right direction. We believe that double-digit interest rates lead to double-digit inflation, which, in turn, will lead to double-digit unemployment in this country, which will be, in my opinion, a blueprint for economic and social disaster as far as this country is concerned.

So, we feel—the Maryland State-District of Columbia AFL-CIO strongly urges the consideration that we presented to you here this morning and hope that you will take back to the Senate our message from the workers of this State. We want to see those interest rates come down.

Senator SARBANES. Thank you very much for a very forceful statement.

Mr. Bowler.

STATEMENT OF GEORGE BOWLER, PRESIDENT, MARYLAND STATE UNITED AUTO WORKERS COMMUNITY ACTION PROGRAM COUNCIL, BALTIMORE, MD.

Mr. BOWLER. Mr. Chairman, my name is George Bowler. And I'm president of the Maryland State UAW Community Action Program.

I agree wholeheartedly with Mr. Bradley's statement, and would just like to add a couple of things.

I think everyone knows the plight of the auto industry at this point. There is basically 300,000 people laid off, not working. And of those, we have 4,000 in the Baltimore area laid off. This has a great bearing on the community as a whole.

Right now the GM plant in Baltimore has 130-day supply of vehicles, which means that any time that plant could close down for a week, a month, or—I don't like to say it, but in my heart, I feel it could close down permanently.

It looks that desperate in the Baltimore area. The people are not working, as you've already mentioned. They are not paying taxes. There is no base for the community to survive.

And unless the interest rate is brought down, it is going to bring total chaos. Along with the automotive industry itself, you have to think about the dealerships.

Coming up from Tennessee last week, along the road, I saw automobile lots just literally packed with automobiles. I'm quite sure eventually some of these people are going to have to close the doors because they cannot sell the cars. I know that the people would buy if the interest rates would do down.

Just one thing I would like to touch on besides that, and I think you are aware of the Essex revitalization that we started in Essex. It seems that that has fallen through now. And not only has it fallen through, but people were going to come into the Essex area, and people who were going to remodel and reorganize are starting to close their doors in that area, too. So, it is a desperate situation, not only as far as labor is concerned, but for the community as a whole.

We would certainly urge Congress, No. 1, to get Mr. Volcker removed from the Federal Reserve Board and get someone in there who is a little bit more responsive to the needs of the people.

And second, urge Congress to reduce the interest rates immediately.

Thank you.

Senator **Sarbanes**. Well, thank you very much.

This is a very important message, and it has to reach the administration and the Fed; they really need to change the basic premise upon which they are proceeding.

Last Sunday Chairman Volcker was followed on the talk shows by Murray Weidenbaum, the Chairman of the Council of Economic Advisers, who indicated that Mr. Volcker and the Fed were pursuing a policy which the administration wished them to pursue—in other words, that they were carrying out the monetary policy that the administration wants carried out.

For starters, I think we have to shift the pressures of both the Congress and the executive branch of Government, the elected representatives of the people, and indicate very clearly to the Fed that there has got to be some moderation or accommodation in their monetary policy.

Mr. **Bradley**. Could I add one thing to you, Senator?

I traveled the whole spectrum of the society in Maryland, sometimes in a day, a lot of times in a week. And I hear from around the country. And I was shocked to hear that the President said that he expects a $60 billion deficit.

I think that the President and the administration, from what I have seen, is whistling past the graveyard. I would not be a bit surprised, because of the interest rates moving—the inflation moving at 15 percent, the double-digit interest rates going up, that we are going to see double-digit unemployment. And those people who are not employed are going to have to be taken care of by somebody.

Senator **Sarbanes**. That's the next point I wanted to ask. For instance, in the construction grades, do you happen to know what the unemployment rate is now?

Mr. **Bradley**. Well, in this area, because of the construction that is now underway, we are doing fine in that particular area, but it is in the industrial production manufacturing area and in government, which has usually been the stable area for employment in this area.

Usually it is the construction trades that goes down, but this time, because of the revitalization projects that are underway right now with the new tunnel and some other things that are going on, the construction trades are setting pretty good.

Senator **Sarbanes**. What about at GM, in the assembly plant? They did not call back what they had proposed to; is that right?

Mr. **Bowler**. As of this point, they have canceled the second shift indefinitely.

Senator **Sarbanes**. How many workers is that?

Mr. **Bowler**. That's around 2,000.

So, we're talking a total of 4,200 people laid off permanently. Construction was completely halted on the construction part of it.

Senator **Sarbanes**. That goes to the point made by the previous panel, that you get momentum going and you get something put together. We had that GM commitment for a $500 million investment here, which was enormously important. Now it appears to be on hold; it may be falling apart on us. We just don't know, and we're extremely concerned about that.

Gentlemen, we thank you for your testimony. It's been very helpful.

Now we will hear from the homebuilders panel, and then we will have the realtors panel. And that will close our hearing.

I appreciate your patience.

I don't know if you have worked out an order, but you can proceed.

STATEMENT OF RICHARD AZRAEL, PRESIDENT, HOME BUILDERS ASSOCIATION OF MARYLAND, BALTIMORE, MD.

Mr. **Azrael**. Senator, my name is Richard Azrael. And I'm the president of the Home Builders Association of Maryland, which operates in the central Maryland area, with chapters in Anne Arundel, Howard, Carroll, Baltimore, Harford, and Cecil Counties, and here in Baltimore City.

I am here today on behalf of the more than 1,000 member firms of our association to protest the high interest rate policy of the Federal Reserve Board.

Last week, our board of directors met for the purpose of voicing our displeasure with the Congress and the administration whom we feel do not show enough concern with the effects of the high interest, tight money policies of the Federal Reserve Board.

It is because of these policies that Metropolitan Baltimore area building permits through July of this year are down as much as 50 percent from previous years and getting worse.

According to the Baltimore Regional Planning Council, normal market demand for the Metropolitan Baltimore area is approximately 14,000 units a year. This represents annual sales of nearly $1 billion.

As has been pointed out by witnesses at hearings held earlier this week, economists determine the true economic impact of this sales volume by using the multiplier of at least two times, raising the full economic impact of a healthy and thriving home building industry to over $1 billion, the size of many national industries. So you can see that the tremendous loss in housing starts has had a dramatic impact on the local economy.

I think it is most appropriate that we are meeting here in Baltimore City, because our studies have indicated a large part of our labor force comes from the city. Because of the housing downturn, unemployment is approaching 20 percent, greatly impacting this city.

It's very difficult to determine how unemployment is impacting on just the housing industry. But I can tell you, from my own knowledge, that locally, here in the Metropolitan Baltimore area, with housing off 50 percent, I would suspect that unemployment is reaching those types of percentages, also.

Homebuilders cannot wait any longer. We need action now to get interest rates back to reasonable levels. Congress has approved the President's economic program. It was our understanding that once this approval was secured that interest rates would drop quickly.

However, of late, even the administration's economists have been saying that rates will continue to stay high at least through the end of the year. We feel this is an unacceptable situation.

We also feel that the current interest rates are much too high, based upon the current inflation rate. We understand that the spread between the prime rate and the Consumer Price Index should be about 3½ to 4 points. Today, that spread is over 12 points.

Additionally, we find credit being diverted toward nonproductive activities such as corporate takeovers and the like. We have been advised that some $35 billion in credit was tied up by large corporations in the recent bidding war for Conoco.

In conclusion, I wish to express the appreciation of our association for you taking the time to bring this national disaster to the attention of the American people.

The bottom line—and we go through many gyrations and marketing sessions, and we beat on the realtors to sell, to sell, to sell. We go through every tool and every gimmick and trick we can think of—of putting a house on the market that the homebuyer today can afford.

The bottom line, when you get through it all, is interest rates. If the interest rates were lower, the spirit—and Mr. Struver spoke about spirit. Well, I happen to be a tremendous believer in spirit and a tremendous believer in momentum and what the buying public needs to be motivated to go on with their life.

We address, and we are so sensitive to, what the buying public wants and where they want to be. Well, our Government has destroyed that spirit and broken it. There are many builders—and I am one, sitting here—with interest rates that are 6 to 7 percent below what the market street rate is.

I still cannot sell houses, and for one reason and one reason only, that that spirit is not there. The Government has destroyed it.

We must find a way to bring us back together, to put us on a program that is going to be spiritually uplifting and motivating to get people thinking positively again. And I think we can do that, but it has to come from Government.

I think our mayor—and I keep going back to Mr. Struver, because I thought he was so right—on when he talked about the movement that is taking place here in Baltimore City. The Government has to put that movement into our country.

Thank you.

Senator **Sarbanes**. That is very helpful.

I think it is evident that the Government has to help establish a framework within which the private sector can then do its job. If the framework is one within which not only can you not do your job, but the question of sheer survival is at stake, something is wrong.

Mr. Simons.

STATEMENT OF JACK SIMONS, JR., CHAIRMAN, BALTIMORE CITY COMMITTEE, HOME BUILDERS ASSOCIATION OF MARYLAND, BALTIMORE, MD.

Mr. **Simons**. My name is Jack Simons, and I'm with the Baltimore City Committee of the Home Builders Association, and will be participating with the Associated Builders and Contractors of Baltimore on their board.

I am here to advocate, in the strongest terms, a change to the basic policy and direction that has forced tight money and high interest rates.

Homebuilding and commercial construction represents the largest single industry in the country. It tries to satisfy a basic need and has been lagging behind this demand. Policy that sets interest rates as much as 12 points above the underlying inflation rate makes it impossible to bring affordable housing to the marketplace.

Baltimore City, under the leadership of Mayor Schaefer, has been a national leader in innovative approaches to revitalization. The evidence of such leadership in public and private sector cooperation are visible in the many projects.

But all of this activity has required intensive planning, a long leadtime, and a basic confidence of the market for these products. Continued high interest rates make it impossible to plan an affordable product; they stretch the time it takes to bring on a product, and they increase the risks.

Mostly, our industry is a small business industry, and what the homebuilders in this area are trying to do is to follow the leadership of Mayor Schaefer and attack the large problem of rebuilding the housing stock.

Members in our chapter believed over the last several years that inflation and the resulting skyrocketing prices were the basic problem with the economy. They indicated that a short, sharp period of high interest rates, coupled with stringent fiscal policy that balanced the Federal budget, was a painful but necessary approach.

Instead, we have been subject to prolonged outrageous interest rates that threaten our industry's survival. Then the word comes down that even with further cuts under consideration, balancing of the budget is years away.

The massive stagnation of our businesses and local economies seems pointless. Even with the furor of the recent spending cuts, the Federal Government is not disciplining itself to stay within its budget, something that would be suicidal for any other entity. It would seem that even the Federal Government is finally feeling the effects of its own policy of high interest and tight money. The Morning Sun ran an article this week that declared a deficit goal of $42.5 billion may be moving as high as above $60 million due to higher than anticipated interest rates on Government borrowings. This suggests a vicious cycle.

Federal borrowings cover additions in deficit spending and put additional pressure on the capital markets; this added capital demand boosts the cost of money for all borrowers and contributes to additional Federal deficits. A break in the cycle by balancing the budget is long overdue.

Other homebuilders' statements have described the numbers and effects. I would like to point out the large constituency being affected. High interest rates are causing builders and developers to delay or cancel new projects and to lay off people in order to survive the current jobs. This effect multiplies to suppliers, manufacturers, realtors, banks, and any group that depends on purchases from these people.

Economists at the National Association of Home Builders estimate the multiplier impact of at least two times actual sales no delivered. This does not count the social impact to consumers who expect but cannot find affordable housing. High interest rates and tight money are a principal cause of these detrimental impacts. I believe increase deficit spending contributes to the high interest rates and tight money.

In conclusion, we recognize the terrible results of the present monetary policy and urge you to force a change.

Generally, this statement reflects a frustration of our homebuilding industry. We recognize the need to adapt to changing conditions in the marketplace, but it is increasingly difficult to adjust when the numbers are extremely unfavorable and there are drastic swings in movement.

One final comment, our numbers, budgets, and so forth indicate that less than 50 percent of a house is actually the bricks and mortar cost. An increasing amount is devoted to land, soft cost, interest, transfer taxes, and all of those things.

And a general trend, I believe, is happening that moves the industry in two directions. The giants are going to survive. The small very-well-captialized businesses will survive. But it will be increasingly difficult for people to break into our business, and it is a point of concern.

And I would like to thank you for giving us the opportunity to discuss these kinds of problems.

Senator **Sarbanes**. Thank you for your very thoughtful statement.

Mr. Meyerhoff.

STATEMENT OF NEIL MEYERHOFF, IMMEDIATE PAST PRESIDENT, APARTMENT BUILDERS AND OWNERS COUNCIL, HOME BUILDERS ASSOCIATION OF MARYLAND, BALTIMORE, MD.

Mr. **MEYERHOFF**. Senator, I'm Neil Meyerhoff. I'm an immediate past president of the Apartment Builders and Owners Council of the Home Builders Association of Maryland.

I don't have a prepared statement this morning. Mr. Simons and Mr. Azrael have talked about the general aspects of our business, and I just will give you some facts.

We are currently building a job in Essex, an FHA program. We have not built a Government program since World War II because we felt that it cost us more to deal with the Government than private sources of capital. Since private sources of capital have dried up for us, we are now building with the Government. That alone raises a $15,000 apartment $2,000, so it's now a $17,000 apartment.

But the problem we have is that we see a $15,000 apartment at 12-percent interest rate results in a rent of $350 a month approximately in this area. And that is kind of high for Baltimore.

So, you sort of have to encourage somebody to rent that apartment: It's a new apartment; it's a good apartment—these kinds of things.

So, you raise the interest rates 3 points and you add another $100 to the rent.

If you got to 21 percent, you're now talking about a $650 apartment, which is out of the range of anybody in Baltimore except the very wealthy, who don't live in apartments.

So, you have, on the one hand, an inability to build the apartments for the tremendous number of people who can't buy houses that my colleagues are building.

By the same token, assuming we could take a risk and build it with 15-percent money, the mortgage bankers say: "You now have a $450 apartment. How do you know there's a market for it? What are your other apartments renting for?"

So, implicitly, he's encouraging you to raise your rent higher on your existing apartments on your existing residents, because he wants you to prove to him and the insurance company that you can get that rate.

So the high interest rate is not only raising the cost of building the new apartments, but you are forced to raise your rent higher on your existing apartments to justify it to the money man, that you, in fact, can get that rent.

That all leads to more inflation.

We are never going to have enough housing in this country for rental or for sale.

With interest rates, we used to say 10 or 12, and probably at 14 percent—unless the mortgage rate comes down to 14 or below and the long-term financing comes down to 12 and below, the city of Baltimore and this metropolitan area, no one will be able to afford to build that apartment.

Thank you.

Senator **SARBANES**. It was developed earlier today in the questioning that when we finally cost it all out, we end up, to afford a median-priced home, needing a $50,000 to $60,000 income, which is not median income.

You're talking about buying a median-priced home, $75,000. Yet the income you need in order to buy that home is probably in the top 10 percent of income families in this country.

And you have the same problem on rentals, I take it.

Mr. **Azrael**. In addition to that, it is compounded, and it's intensive in our field, where we are borrowing—we are so leveraged in everything from land acquisition, development, to building, the bricks and mortar, to buying the end loan, that in a $70,000 house you're talking maybe $14,000 to $15,000 worth of dollars earmarked just for those types of—that type of commodity, the cost of money.

Senator **Sarbanes**. Well, that's Mr. Simons point. You said that under 50 percent was for actual bricks and mortar.

Mr. **Azrael**. It is frightening; it's absolutely frightening.

Senator **Sarbanes**. Let me ask you this question, because it has come up in previous testimony, and it is something I am very interested in. It is: Some of the homebuilders said that the boom-bust cycle of housing was enormously inefficient for them, because they can't put and hold together a work force. In other words, if they can get a good constant level of activity, they can build up a reliable work force, train them, get them into their system.

One witness said that he is now using computers in some of his work, and obviously that is in many instances a new development. People have to be trained in it. He said that every time he lays them off, he finds that when he goes to rehire them, the very best of his people have gone off somewhere else, because they will go find someplace where they are not subject to the ups and downs. Have you all encountered that?

Mr. **Azrael**. It is terribly inefficient, and it makes you so fearful of going out and building an organization. Since 1969, what have we had? Three cycles? This is what we are experiencing today—is something, I think, different than the typical downturn in the housing industry. But how can you build a team and stick in residential housing, for-sale housing? It is almost impossible.

Mr. **Simons**. Coupling that with your observation of the median sales price, if we are subject to boom-bust cycles, and given the fact that a new subdivision might take as long as 2 years, from the gleam in someone's eye to actually putting the shovel in the ground, the lead time is so tremendous, to go through the environmental impact considerations and the sediment control studies, and all the various factors—the project develops a momentum of its own.

You can get FNMA or VA, construction lenders, all of these players. The developer or builder is the crunch point, and he might be 8 months behind his gut feelings to market. Meanwhile, the capital markets have changed, and he has got to readjust. So your median sales price might be high. But it is observing the product that was thought of last year, or the year before.

Senator **Sarbanes**. Mr. Meyerhoff, do you have any observations on this breakup of the work force?

Mr. **Meyerhoff**. We have had that problem throughout the years. The quality of the people coming in is lower each time. The carpenter you lay off the first time and might come back the second time, is not likely to come back a third time. We're also in the maintenance of our apartments, and we're looking to schemes to see what money we can spend this fall to create jobs for our current new construction force.

And we hate to lay them off. We have a work force for 30 years as carpenters, and you don't want to now lay them off. When you think about putting in new doors, and renovating old apartments, you don't want them to leave, because when they do the quality of the building the next year is going to be much less.

The quality of the housing just can't keep up with the loss of skilled craftsmen. There are almost no skilled craftsmen left.

Senator **Sarbanes**. Well, thank you all very much. You have been a very helpful panel.

Now, our realtor panel, Mr. Otis Warren and James Piper.

STATEMENT OF JAMES PIPER III, PRESIDENT, PIPER & CO. INC., REALTORS, LUTHERVILLE, MD.

Mr. **Piper**. Senators, Mr. Warren had to leave. I am James Piper III, president of Piper & Co., Inc., Realtors, with four offices, one of which is in the city, on Federal Hill. I am also second vice president of the Greater Baltimore Board of Realtors. I will make my remarks as brief as possible, because so much has really been covered so well by my colleagues.

Just a few points I want to bring up, one, for instance, to give a frame of reference on interest rates. In January, the interest rates were in the 13½ to 14 percent category. Today, as you heard earlier, they are in the 17½—well, 17 at the least, up to as high as 18 percent, or roughly a 4-point spread. This is basically—well, this is roughly a 30-percent increase, and causes two basic things to occur.

One is that almost all low- and middle-income families are simply priced out of the market. And I'm sorry that Otis Warren, my good friend, and competitor, is not with us to comment more fully on that. And with the average cost of $75,000 on a medium-priced home, coupled with the high interest rates, it just causes real problems and concerns for that level of the buying public.

Second, those families that can afford the high payments are very much on the sidelines, unless they absolutely have to buy, vis-a-vis the corporate executive that comes in from out of town, being transferred. The person that has the good fortune to have large amounts of cash in reserve, in unfortunately the money market and other areas—we would prefer to have it in a savings and loan, of course—but these people are still buying. And the other fortunate thing is quite a bit of our personal business is in that category, although we are spread in both low, middle, and high income.

So I guess to some degree my company is a little bit the exception, in that we enjoy both of those situations: a heavy commitment in corporate relocation and working with middle-to-high and high-income families.

As far as what the real estate industry is doing, or wants to do, about the situation, to try to solve the interest rate crisis, which you may be aware of, on September 7 we are having Interest Crisis Week, which is a very well organized program sponsored by our

National Association of Realtors, which has some 700,000 members, the largest trade organization in the country.

The National Association, together with the State association, which is called the Maryland Association of Realtors, our local board, throughout the various jurisdictions in the State, will all be, starting next Monday, writing our Senators, our Congressmen, the President—anybody that we feel in our judgment can exert influence and try in a positive way to change the interest rates. I think we are a positive group; I know we are—and I think we are as a group very optimistic. But I think that the time has come where we have got to realize that we cannot be stupidly positive. We have to realize where things really are.

And I think we have decided just recently to step out of the crowd and be counted, both as to the way we feel and—I'm speaking with as much belief and integrity as we can, as to how we see the situation, not just for our own selfish interests, but also more importantly for the public who we represent.

So our objective will be to hopefully awaken a very discouraged and pessimistic public to together with us try to get the job done. That is the principal objective. A couple of things that we're going to ask for, or objectives that we hope will be met, will be an immediate decrease of at least 1 to 2 percent in the mortgage rate market, so that our public, our members, that are buying residential real estate, can afford to buy it.

Our long-range objective—or, I should say, our middle-range objective, in the next year to 18 months, is that the interest rate be in the 12 to 13⅞ percent range. We think unless the market gets under 14 percent, as it currently exists, that we're going to continue to have a very difficult, depressed residential market.

And third, we are going to support to all of our worth the saver certificate concept. It's very discouraging, I think, to read the paper this morning, where the Internal Revenue waits until the last moment to make a decision on whether certain things are allowable or not. I think that takes the blush off the rose, so to speak, and that, to me, is kind of discouraging, that that couldn't have been answered ahead of time.

I think banks and savings and loans—how something is sold or publicized is extremely important, psychologically, to whether the public accepts it or not. I just wish them well, because it is going to affect all of us. If the saver's certificate does not work, then we have an even more serious problem, but if it does, it might help the situation.

As far as the real estate firms themselves are concerned, we are seeing more and more not only marginal firms, but firms, small firms, that are good firms, that are maybe not highly capitalized—they are fading out of the market, out of business, or they are being bought by large conglomerates like Merrill, Lynch, like Coldwell Banker, and some of the larger conglomerates. This, I think, is disappointing for two reasons.

One, we need small, good real estate firm; and two, many of them are really being forced to do that, and they are getting really no money, or very little money, for their efforts over the many, many years. There's a lot of sweat and equity that they put into those firms. And their sales are down, they're losing money, so in both areas it is kind of discouraging.

I read this 5 years ago, that this was going to happen, but I still believe that the medium- and small-sized real estate firm will be with us. It has got to be, because that is where I am coming from, and that's where I hope to stay.

I guess that really would conclude my remarks.

Senator **Sarbanes**. I thank you very much. Let me ask you, if a house goes on the market today without some kind of creative financing arrangement, what are the chances of it's selling, or, to put it another way, what percent of what is moving involves creative financing in one form or another?

Mr. **Piper**. Senator, I haven't done any personal statistic, but my reaction to that would be that well over 50 percent in one way or another. There is either owner financing, or some kind of a buydown, or some kind of a program that helps.

Senator **Sarbanes**. Did someone raise a hand?

If you would identify yourself, and volunteer your information.

Ms. **Lurie**. Adele Lurie, from Columbia, Md. Every bit of 75 to 80 percent of the housing in the Howard County market sells with some kind of creative financing, and if it does not, it sells at some type of—of some level, I should say—or distressed market price.

Mr. **Piper**. One of the interesting things, Senator, I think that the values have really leveled off, and in 1977-78, they were going up 10, 12, 14 percent, depending upon location, and certain other things, in price level. Now, most areas have not only leveled off, but when you factor in the fact that an owner takes back at 12 or 14 percent for first or second mortgage when the market is at 17 to 18 percent, really, that owner is losing money. In other words, actually, values are going down because of the tie-in with owner take-back financing.

Senator **Sarbanes**. What happens to families that have to move—the sellers, you know—because they have been transferred by their business or something of that sort? I take it that the length of time that houses are on the market has just increased tremendously; is that correct?

Mr. **Piper**. Yes, sir.

Our listings portfolio is up 60 percent, over last year.

Senator **Sarbanes**. What about the people who have been ordered elsewhere, and have to go?

Mr. **Piper**. Well, if they are fortunate enough, their corporation, their employer, has a contract with a third party company like a home equity or Merrill, Lynch, where it automatically gets taken off their hands. Their equity is given to them on 5 days' notice, and they go to their new place of employment and start to work. They are the very fortunate ones.

The majority of them have to sweat it out, and try to sell it. And if the pressure gets great enough, then they're going to sell it—they will have to sell it, at a loss. They may gave to go to the new place of employment and rent for a period of time, until they can sell their house.

Senator **Sarbanes**. Of course, the fact that that advantage, or that particular benefit, is provided primarily by the large companies becomes another advantage they have vis-a-vis the small business, to attract talented people. As I understand it, those programs are invariably to the benefit of, really, the bigger or the larger corporations.

Mr. **Piper**. Yes; the corporation with maybe 30 moves or more a year.

Senator **Sarbanes**. We had some very interesting testimony on Monday from Bill Byrnes which was very interesting, and I wonder whether his was a general reaction.

He said that the whole quality of the work that was done was markedly affected; that you spend far more time in effect counseling sellers and buyers; and that, he finally said, that it's no fun to be in this business anymore. The resentment and the frustration and the anger that you encounter, he said, is almost constant—although he said he thought after you talked with people that they understood that he was the messenger, and not responsible for the message.

Are you encountering that? Is that a fair summary of what is happening?

Mr. **Piper**. No, I don't think so. I know Mr. Brynes well, and I can imagine him saying that. I think, yes, there is some frustration, obviously. One of my jobs, being president of my own company, is to desperately try to keep my salesmen's attitudes up in a market where some are doing very well and many are not doing well at all. So there is frustration, certainly, but it is still a fun business. Otherwise, I don't think people would be in it. They would be doing something else.

I will say that right now it is extremely difficult to attract good, full-time, competent sales people. It really is very difficult. That whole thing has changed over the last 2 years. There was a flood getting into it, and now there is not a flood moving out, but many firms have experienced rather large attrition going into not so much other real estate firms as going out of real estate and into something else that has a steady salary. Where most sales people are on commission, that is what they live and die on.

Senator **Sarbanes**. Well, thank you very much for a very helpful statement. And again, I want to thank you for staying with us until the end. The subcommittee will stand in recess.

[Whereupon, at 12:45 p.m., the subcommittee recessed, to reconvene at 9:30 a.m., Friday, September 4, 1981.]

EFFECTS OF HIGH INTEREST RATES ON MARYLAND COMMUNITIES

FRIDAY, SEPTEMBER 4, 1981

Congress of the United States,
Subcommittee on Investment, Jobs, and Prices
of the Joint Economic Committee,
Washington, D.C.

The subcommittee met, pursuant to recess, at 9:45 a.m., in room 2-B, Largo Student Center, Prince Georges Community College, Upper Marlboro, Md., Hon. Paul S. Sarbanes (member of the subcommittee) presiding.

Present: Senator Sarbanes.

Also present: James K. Galbraith, executive director; William R. Buechner, professional staff member; and Betty Maddox, assistant director for administration.

Opening Statement of Senator Sarbanes, Presiding

Senator Sarbanes. I think we are ready to get underway.

This is the fifth and last day of hearings this week that the Subcommittee on Investment, Jobs, and Prices of the Joint Economic Committee is conducting to document and examine the effects of high interest rates on Maryland communities and its citizens.

Earlier this week, we heard from a wide variety of business and local leaders concerning how high interest rates have impacted local economies, in Baltimore City, Baltimore County, Annapolis, and surrounding counties, Wye Mills, Eastern Shore, and in Rockville. Today, the subcommittee is conducting its hearing in Prince Georges Community College.

I want to digress for just a moment to thank the community college officials for their hospitality in making these facilities available to us, and also simply to add my own comment on the very effective job which I think this community college is doing here in Prince Georges County.

I have had the opportunity to work with the college on a number of issues and to visit here on a number of occasions. The college is making a very important contribution to the education of our citizens. I'm careful to say not just of our young people. They really have a full-fledged program that goes across the board and is a very important force, not only in the county, but the State.

In six separate hearings this week, the subcommittee has heard from more than 80 witnesses about the severe challenge of high interest rates, a challenge which the witnesses themselves know best since they face it daily in their own economic activity.

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I think it is no exaggeration to say that the problems created by the continuing high interest rates are approaching crisis proportions. The situation this year with the prime rate running over 17.5 percent is unparalled. In the last 12 months, the prime rate has been as high as 21.5 percent. Today, it remains at 20 percent.

The mortgage rate at many financial institutions is over 17 percent, the highest it has ever been. The interest rate in tax-free municipal bonds is now over 11 percent, twice what local governments had to pay only 4 years ago. These rates have created grave obstacles to the operations of many established and productive enterprises, particularly in those sectors of the economy which depend upon a line of credit.

The damage thus far is serious. And if conditions are not soon improved, it will, in my judgment, be irreparable. Enterprises which have been an important asset to their respective communities—and we are talking about highly productive, very viable enterprises—will be lost.

The burden of high interest rates has become a major financial problem for small businesses. Auto dealers and other sellers of consumer durables have been particularly hard hit. For the first time in the history of quarterly survey by the National Federation of Independent Business, small businesses rank interest rates and financing as the singlemost important problem facing them.

The survey which was released last week stated:

> The currently high rates of interest are making a bad situation unbearable for many small firms.

Last year, almost 12,000 businesses failed nationwide, the highest figure in more than a decade and almost double the number of failures in 1978 when interest rates were only half their current level.

The situation is particularly critical in the homebuilding industry. Housing starts last month stood at an annual adjusted rate of just over 1 million, down almost 20 percent from the already-reduced pace of year ago and only half of the 2 million starts needed to meet nationwide demand.

Construction-related business is similarly depressed, with unemployment and construction industry running at 15 percent, more than twice the industrial average. Home sales have fallen dramatically down in Maryland as much as one-third from the levels of 2 years ago.

We had some testimony that said the figures should be 50 percent, not a third.

With mortgage rates now around 17 percent, purchase of a medium-priced house in the national capital area, for example, would require an annual income well in excess of $50,000, an income which is well, well above the national mean.

Financial institutions, particularly savings and loan associations which have done so much to make home ownership a reality, face unprecedented pressures. High interest rates also have very serious implications for the finances of State and local governments.

As a Sunday's New York Times article commented 2 weeks ago.

> These are dark days for State and local treasuries * * * Prices of municipal bonds have been sliding all year and fell to a historic low last week. At the same time, the

interest rates that governments have to pay on their new bonds have reached historic highs.

This is an especially serious blow at a time when State and local jurisdictions must look forward to sharp reductions in financial support from the Federal Government.

The Federal Reserve Bank in Richmond reports that Maryland farmers are now paying the highest interest rate they have ever had to pay for bank loans, with many farmers paying 2 to 3 percentage points above the current prime rate. As a result, farmers across the State as elsewhere in the Nation have been postponing or abandoning productive investments which would make them more efficient and effective producers.

We have heard some very pointed testimony on this subject on the Eastern Shore on Tuesday and on Wednesday from Leon Enfield who is the head of the Maryland Farmer Bureau. And, of course, our first panel this morning will address that subject.

The purpose of these hearings is to document across the State, with testimony from those directly affected, the conditions to which these statistics attest. Over the past 18 months, the Joint Economic Committee, created by the Employment Act of 1946 to provide Congress with economic information and advice, has held a number of hearings on the economy with particular focus on the interest rate question and will return to this matter when the committee in the fall begins its examination of the impact of the recently enacted economic program.

It is my expectation that the report of the Maryland experience established by these hearings will make an important contribution to the committee's work and to the response which policymakers must undertake to remedy this pressing economic situation.

As we reach the end of this week, I must say that I think some of the testimony we have had has been enormously helpful. It was my own conviction before the hearings started that the policy being pursued with respect to high interest rates ostensibly to fight inflation is, in fact, contributing to inflation in a number of very significant ways that conviction has been strengthened.

I am very frank to say I think the premise has to be altered. The economy cannot withstand continued interest rates at current levels. Unless the administration, which has been very supportive of the Fed's position, shifts, and the Fed in turn accommodates, we face very grim times, particularly in certain sectors of the economy. That is the issue we want to seek to develop this morning.

We are pleased to have as our first panel representing the agricultural community, which is enormously important to the economy of this State and the Nation, Wilma Reeves and Roland Darcey.

If you would take the seat and proceed, we are happy to have you. Do you have an order in which you wanted to go?

Mrs. **Reeves**. I will go first.

Senator **Sarbanes**. I think Mr. Darcey and I are still old-fashioned enough to believe you ought to go first.

STATEMENT BY WILMA M. REEVES, FORMER MEMBER, MARYLAND STATE COMMITTEE OF ASCS AND VICE PRESIDENT, REEVES AG ENTERPRISES, CHAPTICO, MD.

Mrs. REEVES. Senator Sarbanes, ladies and gentlemen, I want to first thank you for the opportunity to speak here and try to point out some of the problems of the farmers of southern Maryland.

I've been concerned for some time, and I have said so, about farming in general in this country. The family farm of America has been the most efficient food factory and the most dependable source of exportable goods of any country in the world. Four percent of the population provides food and fiber for the other 96 percent and enough extra for export to make a significant impact on our balance of trade.

But the farmer faces obstacles that are beyond his good management and hard work and long hours to overcome.

The weather will give him some good crops or bad years, but they do seem to even out and are planned for and managed with a little help. The value of his produce is determined by the buyer. The value of his produce is determined by the buyer. He sells by asking: "What will you give me?" Never any cost of production, cost of living, interest on investment is figured in or considered.

The fixed cost of planting a crop has increased at an alarming rate in the last few years. Good seed, fertilizer, fuel for machinery, and the replacement of equipment is determined in cost by a different method of marketing. The inflation and interest rates we have been experiencing have priced the land beyond any possibility of crops grown on it to ever pay for it.

Two bankers I have talked to recently both say they cannot lend money to buy land at the present price and interest rate for a strictly farm operation. Each, in figuring a farm management and repayment plan, say they must have one family member with a good paying outside job to meet today's interest rates.

One says that with a good farm operation, with very little debt outstanding, it is possible to borrow to add additional land with caution. I can give examples of good farmers getting in serious financial trouble trying to enlarge that way.

We have always had an occasional farmer who made some bad decisions and ended up having to sell out and try something else. Neighboring farmers were able to borrow the money and buy the land and equipment and work it into their operation. But in the last month, foreclosure proceedings have been started on three farms. This is something that has not happened in the last 30 years.

Farm machinery dealers are feeling the pinch and are in trouble. Good farm machinery dealers and easy availability of fertilizer and lime and available markets are all necessary to a farm operation.

One local dealer says he is spending his time patching up equipment that should be on the junk heap, but at $60,000 for the smallest combine-cornpicker, the farmer would now be paying $11,340 per year in interest at present rates and would have to pick or combine 500 acres of grain to just pay the interest. That size machine with the owner operating it for wheat, corn, and then soy beans can't harvest much more than that.

Farmers have been helped by good research by the Extension Service, good machinery developed by manufacturers, and innovative ways to fertilize and control weeds and insects.

The comparative efficiency of the system might be illustrated by a few statistics. In 1948, a postage stamp sent a letter across the country for 3 cents, a loaf of bread cost 13 cents, and wheat brought $3 a bushel. Today, that stamp will cost you 18 cents, the bread from 70 cents to $1, and the wheat still brings the farmer $3 a bushel.

I would like to suggest that it is time for you to worry the next time your television commentator says: "Good news, farm prices are down."

Senator **Sarbanes**. Thank you very much, Mrs. Reeves.

I think we will hear from Mr. Darcey and then discuss it with both of you.

Mr. Darcey, will you please state your name for the record?

STATEMENT OF ROLAND E. DARCEY, PRESIDENT, PRINCE GEORGES COUNTY FARM BUREAU AND VICE PRESIDENT, MARYLAND FARM BUREAU, UPPER MARLBORO, MD.

Mr. **Darcey**. Thank you, Senator.

My name is Roland Darcey. I live in Prince Georges County. I have been in the Farm Bureau all my life.

I would like to take this opportunity to thank you and to present a major concern the farmers of Prince Georges County are experiencing with the high interest rates.

Although Prince Georges County has mostly small farms and many farmers working another job on the side, the pressure of high interest rates have been felt throughout our agriculture community.

Our principal cash crop is tobacco, and it cost approximately $1,000 per room to build a tobacco barn to house this commodity. It takes a 20-room barn to house about 5 acres of tobacco, which would cost about $20,000 plus the present high interest rate of 17.5 percent. Therefore, you can easily see why the farmers of Prince Georges County are unable to plan any expansion under these conditions.

Because of the increased production costs and depressed farm prices in grains and slaughter animals, farmers are only borrowing money for the absolute necessities such as fuel, feed, fertilizer, seed, and so forth. Then, they just hope to hang on until things get better.

I might deviate from the testimony. This is what gets more farmers in trouble than anything else—hanging on, not knowing when to make the decision to cut loose or to increase. It is only a human error that farmers have felt because they feel so close to the land.

Due to the large amount of money required in the production of crops and livestock and the long time between paydays, it is necessary for most of us to borrow money to farm. This gives the farmer a tough decision. Do I take a chance and borrow to continue farming or do I quit before I go broke?

Many is the time I have tried to make a decision in the last 2 years: Should I borrow money to continue farming and keep the operation or should I take this cash money, pay my taxes, and then put the rest of it into high-bearing interest rates? I'm sorry to say the last 2 years, I made the wrong decision. I would have had more money in having the money in high-bearing interest rates, but farming is not something you can go in and out.

If we have a small business and it stops, it can sit still, and you can maybe go back into business when things look better. If a farm goes out of business and the weeds grow up and the farm goes down and all the production and all the grains leave it, it very, very seldom ever goes back into production.

I heard a speech from the Farm Credit Bank saying in 1933 that a farm credit employee could walk from the northern tip of Oklahoma to Kansas and never get off of bank land during the 1930's. We hope that this doesn't happen in 1981.

Thank you.

Senator **Sarbanes**. Thank you very much, Mr. Darcey.

I asked Leon Enfield, on Wednesday, about your last point: To what extent are very successful farmers looking at the situation and figuring they would be better to liquidate their capital and invest it in the money-market funds? He said that they saw that that would be better, but loved farming so much that he didn't think a lot of them were doing it yet.

What has been your experience?

Mr. **Darcey**. Absolutely right. As I said, farmers love their land. It is a lifetime position. You just do not give up because, as I say, once you give up, you never go back. The position has been for all the farmers I know of in this southern Maryland area—I'm speaking of the southern Maryland area—none that I know of unless for health reasons, other reasons, not monetary reasons, has given up. They are still struggling and hanging on with the idea that things will look better later on.

Senator **Sarbanes**. Have the suppliers changed their terms—the fertilizer dealers and so forth—from giving a farmer credit over the seed?

Mr. **Darcey**. The terms of the fertilizer dealers and equipment dealers have become very stringent toward the farmer, not because they are mad at the farmer; it is because they also have to borrow money and cannot afford to carry the crops.

Many years ago, the farmers bought their fertilizer and seed from a distributor and waited until they sold the crop to pay. This is no longer the case. They advise you to go to production credit or the local banker and receive the money. You have 30 to 60 days to pay your bill. After that, your interest rates go anywhere from 20 to 24 percent.

It has been known is several cases where farmer have come to different suppliers in southern Maryland on grain and tobacco production, and these banks have advised them not to plant this year if they are financially in that bad shape; to just skip this year and do something else.

Senator **Sarbanes**. Did you want to say something?

Mrs. **Reeves**. The Farmers Home Administration people have said they are beginning to see farmers—of course, this is an organization that deals with people that are in serious financial trouble and can't get a loan through anything else—farmers come in and qualify for loans that they never dealt with before. They have always been above the cutoff point.

Senator **Sarbanes**. In other words, we are really talking not about marginal operators, but——

Mrs. **Reeves**. No, you are talking about people who have been successful and have been good credit risks. And the interest rates and various situations have now put them in a position that they are qualifying for Farmers Home Administration help.

Senator **Sarbanes**. Now, especially in this State where there is so much development. I know the farm commuity is always under pressure, with the land being shifted out of farming into housing developments, commercial developments, and so forth. As an aside, I think nationwide, this is a problem we are not fully addressing, although various efforts have been made to keep land in agriculture. I am fearful that one day we are going to wake up and see that we allowed so much of this to happen that we will be in a situation where we can't really meet our food needs.

Mrs. **Reeves**. I really think you are right; a farming community is a very fragile situtation now. When you are talking about 3 to 4 percent of the population supplying the food and exports and feed of the country, this is a small group, and they are not young people.

This is another thing: we went through a present interest situation of a young farmer who is a good farmer, raised on a farm, works on his father's farm, married, there is no way he can ever buy a farm. Under the present interest situation, he really can't even go and rent land and buy equipment and start it on a tenant basis.

It was in past times that young farmers got their start by being tenant farmers on rented land for a certain number of years. But as I understand, now, this will not financially fly.

With your combine situation, the farm-machinery dealers are really in serious trouble. They have got machinery, they have got overhead, and they can't really figure any way the farmer can pay the interest and buy the machinery.

Senator **Sarbanes**. A farm dealer on the Eastern Shore said in his testimony that he could not in good conscience urge his farm customers to buy his equipment at the terms which they would have to do it. He said he is also a farmer himself. He said, "These people are my friends, and I'm caught in this terrible situation of counseling with them and saying to them finally that they will probably get themselves in too deeply if they move ahead."

Mrs. Reeves, I noticed your reference to patching up equipment. How much of that are the farmers doing? To what extent do you think that the Farmers are becoming less efficient and, therefore, higher cost rather than lower cost producers because of interest rates that preclude them from making investments which would improve efficiency?

Mrs. **Reeves**. This is what patching up equipment causes. You try to keep a machine going past the time when it is fairly trouble free, and then you have got downtime. You can lose crops because your time runs out when it should be harvested.

Wheat and soybeans are more of a time frame than corn. Corn will stand there some. But, yes, patching up the machinery to try to make it go another year isn't an efficient way to operate. It is a very inefficient way because you have got the situation of downtime, broken machinery, where nobody is working until it can be repaired.

Mr. **Darcey**. One of the common jokes among the farmers is to be a successful farmer, your wife has to have a good job. That has been the situation.

Mrs. **Reeves**. That's not the family farm.

Mr. **Darcey**. But it is true that we find ourselves in a situation, not only the increased prices, but the high interest rates at this time have just about absolutely stopped all increasing in agriculture. You try to maintain the volume of agriculture that you have had for some time and not try to increase.

I find this is the first time in the last 10 years where farmers are renting land, leasing land. I find this year available land that has not been leased. As you know, over on the Eastern Shore, you have an experience there where leasing has been extremely important to large farmers with large equipment.

But I find in Maryland some land that has been left idle this year because the interest rates and depression of agriculture have not been encouraging them to ask to lease land in their community. They have cut back.

Senator **Sarbanes** This has been very helpful testimony.

I want to underscore the point both of you have made about the enormous contribution that the farm sector makes to the economy. I think we lose sight of that in this country. I think we lose sight of it partly because you have been so successful.

When 4 percent of your population is able, not only to meet our own food needs for 225 million people, but also to be an important part of our export efforts and, therefore, balance of payments, that is strength. Other countries can't match that. They have a much larger percentage of their population involved in agriculture.

Unfortunately, the smaller the percentage of the population, the more the rest of the country either isn't aware of or tends to overlook the contribution that you are making. It is a funny relationship. And I think that is a very important point.

We thank both of you very much for your testimony. It has been very helpful.

Mrs. **Reeves**. Thank you.

Senator **Sarbanes**. Mrs. Reeves, I want to particularly thank you for your work on the Agricultural Stabilization and Conservation Committee over the last few years. It has been a terrific contribution and important to people of this State.

Mrs. **Reeves**. Thank you.

Senator **Sarbanes**. Our next scheduled panel will be the auto dealers. Are Kenneth Dixon and Mr. Cairns here?

Gentlemen, will you come forward?

I'm pleased to have you here, and I am ready to hear from you in whatever order you want to go.

TESTIMONY OF KENNETH O. DIXON, KEN DIXON CHEVROLET BUICK, INC., WALDORF, MD.

Mr. **Dixon**. Senator Sarbanes, I don't have a prepared statement for you this morning, but I would like to speak to you as a representative of my fellow dealers in southern Maryland. And I'm a representative for them to the Maryland Automobile Dealers Association. And this year, I am also president of that association.

We have been affected many ways through high interest. Inflation is another factor, besides high interest rates, that has affected us by increasing our product costs over the past 10 years, having more than doubled, this burden has now almost tripled.

Contrivedly, our business requires large inventories, not only of automobiles, but of parts and service equipment. My parts inventory through this inflation has increased almost double. The cost of carrying my inventory has tripled.

And when I say "my," I'm talking about my fellow dealers as well. I have a tendency to say "my."

The average used car dealer's inventory cash values have escalated to a point where normally he could carry 40 to 50 cars. For that same money, he can now carry about 17 or 18 cars. So to bring our inventories up even to compete and satisfy and service the public in our area, we had to go, in a lot of cases, to borrowed money. And borrowed money in our case is prime-plus because the local financial institutions, our banks, are out of this type of business.

I don't think there is but one bank in the whole State of Maryland that is still floor planning automobiles for automobile dealers. And they are fast getting out of that business.

So we are confronted with dealing with captive finance companies set up by the manufacturers to finance their products to the consuming public, and finance dealer inventories, such as General Motors' GMAC. We are talking about prime plus. Basically, that is our problem. It is a very strange problem.

Senator **Sarbanes**. Thank you.

Mr. Cairns.

TESTIMONY OF BILL CAIRNS, BILL CAIRNS PONTIAC, MARLOW HEIGHTS, MD.

Mr. **Cairns**. Thank you for coming. I was beginning to wonder if anybody really cared. And I'm glad to see you. Thank you.

My situation is pretty much the same as Mr. Dixon's. It is a little bit more unique. And when I speak, I would like to think that I'm speaking for all the dealers in the State of Maryland, not just myself.

About 4 years ago, I decided to build a new facility in Marlow Heights, Md., not very far from here. And I wanted to build a facility that I would be proud of and be an asset to the community and increase my business so I could increase the payroll and employ more people. So I undertook this large obligation, and I did it.

Now, when I started it, I had a commitment from a bank of a loan at 9½ percent. And that was about 3 years ago. Between the time I started the building and finished the building in February 1980, this high interest rate bonanza started.

The bank was forced to back out of the commitment because they could not fulfill it because of the cost of money. And I had to go with another lending institution. They made me the loan at that time at 1½ percent over prime which at that time still wasn't that bad because prime then was about 10 percent.

But since then, it has gone up. As a matter of fact, this past month, I have been paying 22 percent for about a $2½ million loan. Only because I have been in business and successful for 20 years and have a very good group of employees that have pulled together am I still in business.

My interest bill for the year 1981 just finishing, I will have paid over $1 million in interest between my cost of floor planning, my automobiles that I sell to my customers, and for the cost of my building mortgage—over $1 million in 1 year.

So I feel that I'm an expert in the prime rate problem of today.

If the interest was to come down to a reasonable rate of, which I would never have thought I would say a reasonable rate might be, 13 or 14 percent, but if it would come to 13 or 14 percent, it would be like dominoes immediately, I feel.

I could, therefore, stock maybe 200 more cars which would be more selection for my customers. I would then sell maybe 45 more cars a month. I would then have to have more salesmen to sell those cars. And then, in 3 or 4 months, I would have to have more employees to service those cars.

And immediately in Baltimore, for instance, where there is a large General Motors plant, they would have to put more people back to work to build those cars. And back in Chicago and Cleveland and other parts of the country where they build Goodyear and B. F. Goodrich tires and Firestone tires and plastics to make the seats and upholstry, those people would start back to work.

And it would just be a domino effect all around the entire country. A lot of people don't realize what impact the automobile dealer has on the community and the entire country. I would like to make it be known that it makes a very, very large impact in this industry that the Government for many, many years has been picking on this which is very, very vital to this community, Prince Georges County, as well as this country.

And I just want to thank you for listening to me this morning.

Senator **Sarbanes**. Gentlemen, I thank both of you. That is very pointed testimony about what has happened.

Mr. Cairns, I was interested in your tracing back to what would flow if you could just get a reasonable rate that would enable you to function in something approximating a normal level. You said if we could just get down in a range which, a few years ago, we would have regarded as extremely high under the circumstances, people would be able to move from worrying about how to survive to at least being able to function in some normal way.

After considerable effort General Motors packaged GMAC grants and other things—which are unfortunately, being cut back in the budget, but at that time were available in the city of Baltimore—to upgrade and modernize their assembly division in Baltimore. That represented a $500 million investment.

It meant construction jobs. It did not mean additional assembly line jobs, but it pretty well guaranteed the ones we had. It eliminated fear they might be lost. It meant they would have the most efficient modern plant in the entire GM system.

A week ago, they announced they had put that whole projected modernization, on which they have already spent about $40 million in some beginning stages, on hold. The reason they have done it is, of course, the sales situation which now confronts them, and which you alluded to.

Let me ask you to the extent you are getting buyers now: Has the source of their financing, changed markedly over the last few years?

Mr. CAIRNS. The only place that is willing to finance automobiles at this time is General Motors Acceptance Corp. or Ford dealers, Ford Motor Credit, or Chrysler Credit for Chrysler dealers. Or if you are a foreign car dealer, those car dealers are having a tough time unless they are affiliated in some way with a General Motors dealer. GMAC will then buy their paper.

At one time, bankers of the community were banging on our door, asking for the business. But now, the bankers of the community are scared to death to come by for fear you might ask them to borrow money. So it definitely has changed.

They talked about inflation, by making the interest higher to curb inflation; I wasn't able to pay this million dollars in interest this past year by borrowing money. Fortunately, I didn't have to. It was because I was forced, as well as all the other dealers, to pass the cost of my high interest onto the consumer, my customer. And so my customer is paying my high interest.

I don't see how that curbs inflation. The same with the banks. The banks are charging 18, 19, 20 percent.

Senator SARBANES. The high interest rates become an important factor in the increased costs of goods and services.

Mr. DIXON. Another thing that should be brought out—the person that is not very affluent or doesn't have a very strong credit line is unable at this time to secure a loan to buy either a used car or a new car. And in some of the cars that we see coming into our shops for repairs, it is almost sinful.

We don't have inspection in Maryland. Those people are very fortunate that we don't because they are able to patch up in most cases and not replace.

Senator SARBANES. I wanted to ask you a question on the parts inventory. This is the point that has not previously been developed. A lot of people have talked about their floor plans and how much they have cut back on them, how that then reduces customer selection and so affects sales.

I gather dealers have cut back very sharply on the floor inventory that they carry. That is almost a universal development now; is that correct?

Mr. CAIRNS. Yes.

Senator SARBANES. What about on the parts inventory? I take it you don't have as much room to deal with respect to parts.

Mr. DIXON. In number of parts, the dealer may have cut back. But with the inflation, the total cost of the inventory is up. I think every dealer has taken a look at his parts inventory. And the costs have doubled. In some cases, we have a certain percentage of parts that the factory will take back. But it is a very low percentage of your total inventory. And you end up with many parts in stock, basically there is nothing you can do.

Mr. CAIRNS. It goes back to the problem of the consumer as being inconvenienced again. At one time, I used to carry almost $500,000 in parts inventory—3 years ago. Today, the same inventory would be about $700,000 for what it would have cost 3 years ago because of the price the parts have gone up.

However, today, my inventories in my parts department is only about $250,000. What happens is the consumer who would have come in 3 years ago who might need a strange part for their car, I would have had it in stock. Today, the consumer is put out because I don't have that part. And they have to wait 5 days. And at times, their car could be out of commission for 4 of 5 days.

It just keeps going back to the poor consumer is the one suffering in the long run. And they are the one paying. And it all stems from the cost of money.

Somebody said money is the root of all evil, and I believe it is very true this time.

Senator **Sarbanes**. What is the length of time now that you are generally working with the auto payments? Has it gone to 48 months here?

Mr. **Cairns**. Yes.

Mr. **Dixon**. It is almost all 48 months on new cars.

Senator **Sarbanes**. As contrasted with 24 or 36 which used to be the standard; is that correct?

Mr. **Dixon**. That's correct.

Mr. **Cairns**. Yes, sir.

Senator **Sarbanes**. What is the reason for that? Is it only by extending the time because of the high interest charges that you can get the monthly payment down to a level where the consumer can carry it, or is there some other reason as well?

Mr. **Dixon**. It is the only way they can make the payment.

Mr. **Cairns**. The cost of the product has gone up also, but the difference in interest rate between—if the prime was 13 instead of the 20 percent today, the difference in an interest rate on an average consumer's payment per month could possibly be $50 a month or $600 a year.

That is just a rough estimate. The higher the price of the car, the more it would be, of course. If prime was 13 instead of 20, the cost of payment to the customer would be approximately $50 a month less or even more than that because then we could possibly sell the car for less money. I wouldn't have to pass on those costs.

Senator **Sarbanes**. Has the manufacturer tried to change the terms which they deal with you in order to shift the burden to the dealers, or do they in effect regard themselves as being in the boat with you?

Mr. **Dixon**. Which way are you talking about—some relief as far as——

Senator **Sarbanes**. In terms of tightening up their terms, requiring you to put your money up sooner and so forth. Have they tried to shift the burden onto you or have they tried to figure out ways where you are both confronted with it and work together?

Mr. **Dixon**. Senator, General Motors doesn't build an automobile that is not sold to the dealer. When it comes off of their assembly line, it is sold to the dealer. And as it passes out of their building, it is paid for. Either the dealer pays for it cash, or he has a floor planning set up. And it is assigned to him immediately. And his floor plan starts at that time.

Senator SARBANES. I take it that GM's 13.8-percent plan, has now been extended for another month?

Mr. DIXON. To the 24th, I believe it is.

Senator SARBANES. I understand it has been quite successful in encouraging sales; is that correct?

Mr. CAIRNS. I wouldn't say that for sure. They would like to make everybody believe that. It has helped somewhat.

What the general public does not know is General Motors picked a rate, but the difference between the 13.8 and the old rate is being picked up by the dealer. We had to subsidize it. And it comes out of our potential profit. That is where the differences come. And it has come out of gross profit as well as net profit for the month of September and the month of August.

I think it was a bad move. It did stimulate some sales, but only so that they could sell more cars to us, the dealer.

There is no negotiation with the factory, whether it is General Motors, Ford, Datsun, or whoever. They build a car. If they figure the car is going to cost *x* number of dollars to build, they figure their profit in there, and they make up an invoice, and we pay it.

When we get the car, we can't do that. We have got to negotiate. If you don't like our price, you go next door, down the street, or around the corner. They don't have that negotiation problem; we do. We are in the community and in business; they are not. For the business, they are not.

Senator SARBANES. The final question I want to ask—and I think it has really been answered—is the extent to which this situation is pushing established, effective, productive businesses against the wall. We heard Mr. Kaufman testify in Annapolis; you all know him. He has won awards 2 out of the last 3 years as one of the best dealers in the country and so forth. And he says he just can't cope with the situation.

He said it is not marginal people who for one reason or another—inefficient management, undercapitalization, whatever it may be—shouldn't be in the business, who are being squeezed out. He says your very best people are unable to cope with this situation and are being pushed to the wall. And I take it from your testimony, you agree with that characterization.

Mr. CAIRNS. That is the sad part of it. We are losing a lot of good businessmen; not just bad businessmen are going broke. In the last 2 years, a lot of good ones are. The bad ones have already gone. They left 2 years ago. They went first.

The sad thing is a lot of the family-type business, around 40–50 years, three or four generations, this generation, because they have made some money and made some good investments over the years, have just locked the doors. They didn't go broke, they have just locked the doors of their dealership in their community and sold the real estate for something else.

A lot of them who would have liked to have sold the real estate for something else are sitting on the real estate because they can't sell it under these conditions because of the prime rate.

Mr. DIXON. Senator, I was just reading this article from our national organization, and we have so far this year lost 486 dealers nationwide.

Senator SARBANES. Well, gentlemen, we thank you very much.

Mr. **Cairns**. Thank you very much.

Senator **Sarbanes**. Very good testimony, panel.

I understand that Dennis Madden, president of the Prince Georges Chamber of Commerce is with us.

Mr. Madden, we would be very pleased to hear from you now. We appreciate your attending this morning.

STATEMENT OF DENNIS W. MADDEN, PRESIDENT, PRINCE GEORGES CHAMBER OF COMMERCE, LARGO, MD.

Mr. **Madden**. Good morning, Senator.

My name is Dennis W. Madden. I am president of Prince Georges Chamber of Commerce. Prince Georges Chamber of Commerce includes within its membership nearly 800 business organizations serving this area. Our members range from large corporations and institutions to small mom and pop businesses.

Since this is the fifth day of a full week of public hearings on this subject, it is not likely that anything I say will come as a surprise to the members of this subcommittee, and therefore, my statement will be very brief.

The chamber through its day-to-day contacts with its membership is in a unique position to feel the pulse of business of Prince Georges County. I think it is safe to say that we do not have a single member who is not affected in some way by the current inordinately high interest rates prevailing today.

Some particular segments of our local economy appear to be more severely impacted than others. For example, the home building industry, the auto dealers, and the financial community, especially the savings and loan institutions. A spokesman for these segments of our business community either already have appeared or will appear later to outline their current problems. They can speak directly and in depth of the effect of high interest rates on their businesses. There is little point in my repeating their story.

I would like to make a few brief comments from personal experience. Today, I am wearing my hat as president of the county chamber of commerce, a volunteer job. In "real" life, I am head of an architectural and planning firm which does most of its business in this county.

Two years ago, our firm was designing quite a few residential units, both single-family and multi-family, to be built in Prince Georges County. It has now been about 6 months since we have had a single housing unit on our boards. We are still involved with other building types—for example, office buildings.

Office buildings are still economically viable due to the invention of the passthrough lease. The scenario goes like this: A developer decides to build an office building. Because of inflation, he has to pay more for his construction money and his permanent financing than last year. This forces up his total project cost. Not to worry, he simply passes along these higher project costs in the form of higher rents.

The business firms who rent space in the building also have higher costs as a result of this increased rent. They, in turn, pass along these higher costs in the form of higher charges for their goods and services. This causes more inflation.

The next developer who decides to build an office building pays still more for his construction money and permanent financing and so forth. It becomes not only a vicious circle, but a flywheel with a momentum of its own.

I leave it to you to imagine what will happen to our economy if this process is allowed to continue.

This circle must be broken, and quickly, before we all go down the drain. As independent businessmen, chamber members normally tend to favor letting the private sector work out its own problems with as little interference from Government as possible. In this case, however, it would appear that only action by the Federal Government can turn this situation around.

We see this necessary Federal action as taking two forms. First, control by the Federal Reserve Board of our money supply must recognize the severity of the current trauma. Problems which have been building up for many years cannot necessarily be solved overnight.

Second, Government spending must be substantially reduced to correct the huge budget deficits which have been a major cause of the inflationary pressures precipitating this crisis in interest rates.

I would like to read a little article that came in today's issue of Nation's Business under the heading "Milestones We Would Rather Ignore Department."

"The national debt is likely to pass the $1 trillion mark sometime this fall. The administration is expected to opt for a modest observance limited to members of the immediate family."

On behalf of the chamber of commerce, I wish to thank you, Senator, for creating this forum to allow us to express our views.

Senator **Sarbanes**. Thank you, sir, for a very helpful statement.

I might note that, following on the testimony of Mr. Cairns and Mr. Dixon, the Fed's high interest rates increase the carrying charge on the existing national debt, thereby contributing to the deficit.

And, second, to the extent they threw people out of work—and they have obviously done that in a number of sectors in the economy—people, who previously were working, earning, producing, and paying taxes, who have ceased paying money into the treasury and have started drawing unemployment and pulling money out of the treasury.

Mr. **Madden**. Double wammy.

Senator **Sarbanes**. So we get the double blow.

No one is pushing the Fed simply to throw the floodgates wide open.

I was interested in the testimony before that said if we could get down into that range that was mentioned, they at least could function.

Mr. **Madden**. Range that used to be considered intolerable 3 years ago.

Senator **Sarbanes**. That's right. Then the economy would start to move, and all of these pieces would begin to fall into place.

I want to ask about the national studies which have shown that small business is almost totally dependent on debt financing, in contrast to large businesses, who are in a better position to either use equity money or use retained earnings. I wonder if that is your experience and whether you would substantiate that view.

Mr. **Madden**. I think it depends to a certain extent on the type of business. I believe some of the more service-related businesses that don't have inventory problems and things like that generally are internally financed to a large extent. But certainly anyone who has to have a large infrastructure, real estate, to run his business or has to have a line of credit, is obviously at the mercy of this high interest rate.

Senator **Sarbanes**. Well, thank you very much. We appreciate your joining us this morning.

Mr. James Ricci of the Education Systems Employees Federal Credit Union and Mr. Jerry Whitlock, the executive vice president of the John Hanson Savings & Loan, Inc.

Mr. Whitlock, I guess Mr. Ricci is not here with us, so will you proceed, please.

STATEMENT OF JERRY D. WHITLOCK, EXECUTIVE VICE PRESIDENT, JOHN HANSON SAVINGS & LOAN, INC., FORESTVILLE, MD.

Mr. **Whitlock**. Thank you, Senator.

I would like to take this opportunity to thank you for holding these hearings so we as citizens, property owners and workers in Prince Georges County could express some of our views concerning the present economic conditions.

It has not taken an astute reader or listener to be aware of the current high interest rate scenerio that exists today in their area. All one has to do is pick up the Washington Post and read the ads for the high rates that are being paid by banks and savings and loans and mutual funds to see that unprecedented rates are being paid today.

Every week, a new record is set on treasury bill offerings by the Government. And the person going to the grocery store on a weekly basis sees prices increasing almost before he can get out of the store. High interest rates today are causing these situations.

What one may not correlate with the rates being paid to savers and investors is that on the other side of the ledger, there has to be someone who has paid an even greater price for the use of that money. The user may or may not be the same person who has money to save or invest. But at one time or another, most people will need to borrow for some specific purpose.

While it may be elementary, it is useful to consider some of the components that make up the interest rate. Obviously, the amount being paid to the saver or investor is part. And then there is an amount necessary to cover the expenses of operation, plus a profit.

The first aspect of what is paid to the saver is a market condition determined by what the various financial intermediaries are willing to pay and what they need to attract funds to conduct their operations. The profit aspect fluctuates in accordance with the yield on investments, but will always be figured on future transactions.

The expense of operations has wide variations, but a good part of this has been determined by compliance with Government regulations. And the more regulated the business, the more costly this aspect will be. The end user of money always has to pay for these interest rate variations.

The wider issue is: how well does the interest rate level balance the supply of capital with public and private demand for loans? So the interest rate is of vital concern to us.

We in Prince Georges county are faced with the same problems that exist elsewhere. Interest rates are at such a high level that it has stopped a good number of us from accomplishing the goals we thought so important. One of these goals has been to secure a home at an affordable price. And here, we have suffered greatly throughout this inflation and interest-rate cycle.

I would point out to you that just because of the interest rate increase in the past few years, which has gone from the 12-percent range to the 17-percent range, the payments on a $50,000 loan have risen from $514.31 per month for principal and interest to $712.84.

If the standard rule of paying not more than 25 percent of income is applied, and taxes and insurance are added, it means a family has to now earn about $3,200 per month instead of $2,400 a month 2 years ago to get the same loan. When added to the increased price of housing, it has taken most of our citizens out of the home-buying market.

As we are all aware, housing has a significant impact on a lot of people. When new housing construction is cut down or off, it affects plumbers, electricians, carpenters, furniture makers, appliance manufacturers, and a whole host of other people who depend upon continued building programs for their livelihood. Builders are not building because the interest rates are so high and have caused them to price their product so much higher that they aren't sure they can find a purchaser who qualified for a loan.

In addition, as rates go higher, the current homeowner who wants to sell his home for one reason or another finds it exceedingly difficult to sell at the current price and interest rate. Many homes have been on the market for over a year without selling. And so the very fact that a homeowner has a great deal of equity in his home is not of any benefit to him because he can't sell to get his equity out.

In 1958, the average interest rate on loans was 6.1 percent as opposed to the current 17 percent rate, and no one knows what the rates will do in the near or distant future. So we have developed a frustrating and uncertain condition affecting a large segment of our population.

High costs coupled with the instability of market conditions does not allow us to plan for the future and to satisfy our needs when we don't know what is going to happen.

In talking about this subject with various people, I have gotten a clear indication that most realize that some hardships are bound to occur as we try to correct this high interest rate and high inflation cycle. Human nature always makes one think it will be the other guy to whom this will happen, whoever that may be. The "other guy" right now is the builder, the farmer, the family on a fixed income, the small businessman, the investor with long-term investments yielding low rates, and many, many others. Many have and will say that the hardships have now been enough, and that it is time to alleviate this suffering.

We as citizens cannot rightly place blame for the current conditions on any one segment of our economy. It is not our purpose in hearings such as this to place blame, but to see if we can suggest and help with policies that will improve the current conditions. Most of us do not have the solution because the problem is not of our making, but we would urge this committee to use its expertise and influence to bring interest rates down so we can get on with the business of daily living and planning for the future.

In its most simplistic form, it seems to us as citizens of this country that we have to find the ways and means to increase our productivity which cannot be done by driving our producers out of business. Increased production will solve most of our current problems if the interest rate does not drive up prices faster than we can produce. Given the proper amount of time, we in this country can and will adjust to higher interest rates, but not to the level at which they are today.

While we may not reasonably expect great reductions in interest rates tomorrow, we can ask for and work toward having a stabilized situation and with that kind of confidence work on programs which will benefit all citizens everywhere.

Thank you, Senator.

Senator **Sarbanes**. Thank you, sir, for a very thoughtful statement.

Let me ask you, are your depositors leaving S. & L.'s? Are they leaving in numbers, or do they stay with you as depositors, but simply shift a large part of their funds away from you?

Mr. **Whitlock**. Essentially, we are having an increase in savings within the system here in Maryland, but at very, very high rates. We are not losing too many of our existing customers today, but we have in the past to the mutual money market funds and operations such as that.

Senator **Sarbanes**. Let me ask you this question: What is the median price for a home in Prince Georges County, roughly speaking?

Mr. **Whitlock**. Well, in the medium-price homes in Prince Georges County, they are in the $65,000 to $70,000 category. And there are not a great many of those, quite frankly, that are being built.

The homes that are being built today in the county are more of the high-priced level. They are being built for people who can afford or are willing to take the gamble on today's market to have a nicer home.

Senator **Sarbanes**. That point was made to us by a lumber dealer on the Eastern Shore, who said the one market that was not affected was the very high-priced home, the custom-built home, and the vacation home market.

Mr. **Whitlock**. Right.

Senator **Sarbanes**. He said, you don't even talk about lower-income housing, or housing for middle-income people. It is just not there.

What kind of income would you require of a family before you would say they ought to move ahead on a $70,000 home?

Mr. **Whitlock**. It would probably have to be in the minimum of combining $40,000, $45,000 in order to qualify. We used to have a rule of thumb that you could generally have a loan at about twice your annual income. Now, we are cutting that down to the point where it is probably in the range of about 125 percent of your current income that you can qualify for the loan.

So if you have, say, a $50,000 income, you probably qualify for about $62,000 or $62,500 loan.

Senator SARBANES. So what has happened is that the income to qualify for a median-priced home is an income that is well, well above the median income.

We have a mismatch between where people rank in the income scale and where the housing ranks in cost. A $50,000 income puts a family, as I recall, in the top 10 percent of income in this country.

Mr. WHITLOCK. The serious thing we are fighting at the present time is it is almost impossible for a family to buy a home unless both husband and wife are working. I believe personally that this has a great consequence on the family formation and stability of the families here in our county because of this.

Senator SARBANES. What is the attitude you take when you get a young family coming in? Husband and wife both are working. They can qualify with two incomes put together.

But then, you look at the situation, and you know they have been married a year or something. You have to anticipate a family. What will happen to the income? How do you address that, just in human terms when it comes before you?

Mr. WHITLOCK. Well, under Federal regulations that we have today, we are really not permitted to address that issue of future family formation and what the effects on the income will be. We will have to underwrite them as if they were not going to have a family at that particular time.

If they are qualified for the loan, we would extend the loan to them. There are some dangers in that family unit, though, as you have just pointed out, as to what happens if one of those incomes gets cut off.

Senator SARBANES. How many defaults do you eventually have in a situation like that?

Mr. WHITLOCK. The defaults in the mortgage loans are not that great right now. What we are experiencing is more slow pay rather than going into the actual foreclosure. A family realizes that they have got to have shelter, and they will give up a lot of other things before they will give up that home. It is a high priority item on their part.

So while they may have to skip a payment here or there and struggle to make it up in the future, they will do the most they possibly can rather lose a home.

Senator SARBANES. Do you find that the percent of income that they are prepared to commit to housing has been raised?

Mr. WHITLOCK. Well, they are prepared to commit much more to housing than they were, say, a year or 2 years ago. However, that doesn't really help us in underwriting a loan to determine whether they are qualified to do it or not. Unfortunately, I think we have to act under ratios rather than perhaps giving as much individual consideration as we would like to. We have to find out about the life styles of each individual couple that comes in.

Senator **Sarbanes**. That, I assume, creates some sharp tensions on occasion in dealing with perspective home buyers. You have to operate from a standard, so to speak, of a sensible ratio built up over experience.

I would take it that a lot of them say they are prepared to do much more than the ratio requires. And you then have a sort of a tense situation.

Mr. **Whitlock**. Very tense. We are finding that most of our real serious delinquency problems are coming about because of divorce in the family, divorce and separation.

Senator **Sarbanes**. Well, thank you very much. It has been very helpful testimony.

Now for our labor panel, Mr. Quackenbush and Mr. Schnabel, we will take you all now. Which one of you would like to go first?

STATEMENT OF HARRY SCHNABEL, JR., PRESIDENT, SCHNABEL FOUNDATION CO., BETHESDA, MD., REPRESENTING THE METROPOLITAN AREA CONSTRUCTION CONTRACTORS COUNCIL—ASSOCIATED GENERAL CONTRACTORS

Mr. **Schnabel**. Good morning sir.

My name is Harry Schnabel, Jr. And I am here representing the Construction Contractors Council—Associated General Contractors, metropolitan area. We exist solely to negotiate labor contracts with the basic building trades and to administer those contracts.

Our members employ most of the union construction workers in the metropolitan area. I am a member of the board of directors in this organization and also have served as it president in the past.

As Mr. Madden said, I also wear another hat. I am also a businessman. I have been president of a small contracting company chiefly because I founded it and own it, but we elect the officers. We specialize in foundation subcontracting.

I personally believe that inflation is the major problem and must be controlled. Clearly, we have had an increase in unemployment as inflation has increased.

My industry, construction, has been hard hit in those counties I have visited which have high inflation. Long-term financing has become very difficult as borrowers have been able to pay back with cheap money. However, anyone who has been in downtown Washington has to be aware that we are in the midst of a building boom. Last year was the first time in 5 years that we have an increase in employment in union contractors.

For about 5 years, there has been a steady decline in union employment in this area. All of the trades we employ were affected by this decline. And the number of men working is roughly half the number employed in 1974.

This has resulted, I believe, from two chief causes—the end of the subway program and increase in the amount of nonunion work. For several years, we have been negotiating to increase our competitiveness. As just one example, the total wage increase in the years 1977 through 1980, in the union industry was only 13.5 percent.

I believe these efforts have begun to pay off. For example, I am a trustee of the Operating Engineers Welfare Fund. And last year was the first time in 5 years that the decline in members who qualified for benefits stopped, and we had a slight increase.

In conclusion, many of us are concerned that the Government borrowing programs are the cause of inflation. High interest is a symptom that is emotional because it can be tinkered with.

The most significant thing that you gentleman can do is to show the determination to control inflation. And I encourage you to do that.

Thank you.

Senator SARBANES. Thank you, sir.

Mr. Quackenbush, please.

STATEMENT OF JOHN R. QUACKENBUSH, SECRETARY-TREASURER, WASHINGTON BUILDING AND CONSTRUCTION TRADES COUNCIL, HYATTSVILLE, MD.

Mr. QUACKENBUSH. Good morning.

The problems created by prolonged high interest rates affect construction workers in two ways. A lack of job opportunities is one of the affected areas. Washington, D.C., is known throughout the industry as being recession-proof. Today, this stereotype is holding true; Washington is still "fat city" for construction.

Associations looking to get their piece of the Federal pie are paying the higher rents generated by the high interest payments; insurance companies and foreign investors are placing large sums of money into the Washington area.

The Federal Government continues to contribute yearly to a healthy construction economy. The slowdown has occurred in the outlaying counties on privately financed work.

The difference is not in who is building, but who is not. The competent auto mechanic cannot build his own station or garage. The only people building gas stations are the large oil companies. The would-be owner of a small store cannot build. Only the multinationals and large chains can afford the financing. Housing has all but been eliminated. The large companies can build, but the typical working couple cannot afford to buy.

This leads us to the second part of the problem: impact of high interest on workers' lives. For most young workers, buying a house or a new car is completely out of the question. Those of us who are able to purchase a home under the FHA program with 5½ percent loan are living in a days-gone-by era.

Condominium, car and credit card purchases have strained workers' budgets to a breaking point. At union meetings, the cry for more money in the pocket is regularly heard, along with the pleas from retirees for higher pension benefits. At negotiations, the inflationary spiral is pushed ever higher with increased wages, resulting in higher prices, and on and on.

There are no easy solutions to the vicious cycle our economy is caught up in; however, the Government has to be the force which keeps balance in the financial sector. Most importantly, this should be done without the workers having to carry the lion's share of straightening out the economy.

Senator SARBANES. How much resentment are you encountering on the part of workers who sense that they are unfairly being closed out of economic opportunities that they think ought to be available to them—the home, the car, and so forth and so on?

Mr. **Quackenbush**. I personally have seen it with the younger workers, those in the 20- and 35-year range, or the 18 to 30. I guess the American dream has always been a house, a car, a good life. And at least for two of those items, it is completely out of the question.

Our construction workers, the stereotype, work about 1,500 hours a year, probably earn about $20,000 to $21,000. As compared with the previous speakers, they can't afford to buy a home; they can't even think about buying a home. The new car, that is completely out of the question, new pick-up truck or whatever.

The prolonged, long-range problem that this creates, I don't know what it is going to turn to, but to the individual right now, there seems to be a great deal of discouragement, and to be caught into a cycle that they see no hope and no way out of. What is going to be the prolonged effect 2 or 3 years from now or 5 years from now when the belly rubs the backbone, it is going to be a little difficult to say.

Senator **Sarbanes**. The other question I wanted to ask is: what effect do you think it has on the efficiency and skills of craftsmen in the building trades not to have steady and continuous employment—to be up, to be down, to be off, to be on? Just looking at it from a somewhat broader perspective, do you think that has a negative impact on their efficiency and, therefore, our ability really to be more efficient producers? Or do they just weather the storm and come back as efficient as they might have been if they had just stayed on working?

You both might want to address that.

Mr. **Quackenbush**. My major reaction is if you get worried about being fired or worried about being laid off, you don't work in the construction industry. Normally or historically or whatever, you work for 4 or 5 or 20 different employers in the curse of a year. You go to work, you do your job, let laid off when the job is over. It doesn't bother them a bit.

Senator **Sarbanes**. Mr. Schnabel.

Mr. **Schnabel**. I guess that's probably true. I agree with Mr. Quackenbush.

Of course, everybody talks about the high wages in the construction field. And one of the reasons they are high is to compensate for that, to make it attractive to work here, even if you don't work every day.

Senator **Sarbanes**. What kind of construction are you all talking about? Some of the homebuilders testified thus far that they put together a team, as it were, that they build up; and that their efficiency is markedly affected when they have to disband that team and let them go because the next time around, either they can't get some of their best people back or they have gone elsewhere.

Is there a difference between the residential home building and the construciton of large offices or commercial projects?

Mr. **Schnabel**. It is the same thing. Basically, we have an organization, and people work fairly steadily. But when we have a surge, we employ people, and we discharge them when the work slows down. That is routine.

And it is something like the subway which doubled the number of construction workers in Washington. People came from Detroit and Philadelphia and New York and Atlanta, and worked. And now it is finished or finishing, they have gone to Baltimore or Boston or Buffalo or someplace else where there is another subway coming.

Senator **SARBANES**. Well, thank you very much. We appreciate your testimony.

Mr. **QUACKENBUSH**. Thank you.

Senator **SARBANES**. Mr. Glendening, I know you have a very difficult schedule this morning. I think we will take this opportunity to hear from you if you would come on up.

Frank Komenda is going to join that panel; would you come on up, please.

And State Delegate Donaldson is with you, Mr. Komenda, as I understand. And we will be happy to hear from him.

Is the mike on up there?

Then, we will go on to the panel. We have the realtors and homebuilders to hear from this morning. That is just so people will have some sense of where we are. I appreciate the patience of people in waiting their turn.

We will be glad to hear from you, Mr. Glendening.

STATEMENT OF PARRIS N. GLENDENING, CHAIRMAN, PRINCE GEORGES COUNTY COUNCIL, UNIVERSITY PARK, MD.

Mr. **GLENDENING**. Thank you, Senator. I appreciate your patience.

I want to speak from two perspectives: one as chairman of Prince Georges Council, representing specifically the interest of the citizens of this county; and also if I might from some of my research at the university, the impact that is going on for planning assigning of loans.

I appreciate the cooperation of my colleagues here in letting me speak first.

I have a prepared statement for the record.

Senator **SARBANES**. It will be included in full in the record.

Mr. **GLENDENING**. The major impact has been twofold.

One is of the cost of financing local government, and particularly Prince Georges County government, in terms of interest rates.

And two is in the cost of business in the county as to our revenue picture.

If I could start on the bond issue for the county, as you are aware, local government finances its capital construction projects by municipal bonds. The impact on the bond market of the high interest rates nationwide has been alarming. For example, the cost of Prince Georges County bonds from 1977 to 1981 jumped from 4.99 percent to 12.5 percent. The bond costs increased 2 percent in the last 6 months alone.

The bond market is crucial for us because this is the primary source of funding we need for construction, not only for the county, but for agencies that we fund or approve their bonds directly or indirectly. By this, we are talking about the county facilities, the

Washington Suburban Sanitary Commission, 28 municipalities that are in the county, Washington Metropolitan area Transit Authority, Park and Planning Commission as well as a few of the smaller agencies where we have capital construction projects.

The additional cost to the taxpayers of Prince Georges County since 1977 in the bonds we have issued—and I assure you they have been very limited because of the conditions of the market plus the high interest rate—has been $35 million. We have paid $35 million more, and committed ourselves to $35 million more, since 1977 over the 1981 bond issue.

The key, of course, is this is paid for by our local taxpayers. And most important is the bonds are guaranteed by the property tax.

As you are aware, we have TRIM and other situations which make this even more complicated.

Our alternatives are to defer construction, and we have done this repeatedly. And as my colleagues can say, they have a number of projects that citizens have been seeking. I think they are justified. Specifically, a couple of them in this plan here, we simply haven't been able to fund.

The other is to have a pay-as-you-go system. It becomes very, very difficult under the constraints that we have of TRIM overall.

The alternative, of course, is to fund a minimum amount at these extraordinarily high interest rates. Let me give you a specific example of what we are talking about.

One million dollars of construction bonds in 1975 would have cost 6.19 percent, did sell for 6.19 percent.

Senator SARBANES. When was that?

Mr. GLENDENING. In 1975, that cost us, over a 25-year bond period, $978,892 in interest. Last year, we agreed on some additional bond sales which we sold in July 1981. One million dollars in bonds at this point sold for 10.59 percent. The cost to the taxpayers was $1,865,000. And in that short time period, $1 million cost us almost an additional million dollars in interest.

Senator SARBANES. Could I ask what the term on the 1981 sale was? Did you still go out at 25 years or did you have to shorten your term in order to try to get a better interest?

Mr. GLENDENING. We ended up with 20-year negotiated. We negotiated 20 years.

We have other impacts that are affecting the revenues of Prince Georges County and the other local governments in the immediate area as well as nationwide.

The high commercial loan rates increased the cost of business inventory. These costs are passed on to the county government.

We also have such things as the slump in the sale of automobiles. We are losing revenue from vehicle registration fees. And most important for this county is the staggering drop in building activities. There are a variety of factors affecting that, but we are convinced the major factor is the high cost of securing a home loan.

In terms of impact on the county in addition to other social costs associated with unemployment, we lose in terms of revenue moneys from recordation and transfer taxes, building permit fees, and a variety of other revenue sources.

Our main revenue source, property tax, is frozen by the tax limitation adopted by the voters in 1978. As a result of this, we must rely on these alternate sources of revenues. And this slows down and causes a significant impact to us. But building industry, in terms of direct revenues for the county, contributes approximately $21 million. That is direct in the sense of recordation and transfer taxes, things of that type. We have seen a significant decline in them.

In the area of econmic development, the county, working with the State government, has been trying to assist the private sector to overcome the high interest rates. Our major area of activity has been in the industrial revenue bonds or MIDFA bonds, and industrial revenue-related bonds such as the housing bonds. We have had growing demand for these bonds. Some of them have been very large issues.

For example, we just recently approved an industry revenue bond for Pepco for some of its environmental control projects in the amount of $42 million. Others have been lesser amounts, around $500,000, for different housing projects.

As a general rule, by going through the method of industrial revenue bonds and creating financing, we can knock off about 2 percent with a private builder. However, we are running into difficulties here.

No. 1 is obviously the threat of the IRS ruling that would limit our use of this.

No. 2, we are incurring problems because we are in effect creating two markets in Prince Georges County—one subsidized by IRS, one competing on the totally free, private market.

In addition to this, there is a possibility that the State will impose maximums here which makes sense in terms of the amount that is being used statewide.

Far more important is that we are reaching the saturation point in terms of industrial revenue bonds for sale through private banks. In the last several issues, we have been informed by the holder of the bonds, they are having problems selling the tax subsidized amounts.

In sum, the high interest rates are hurting them in Prince Georges County, but also all the related local governments here in a number of ways. They are hurting the taxpayers the absolute minimum amount. Additional cost that we would identify is $35 million to be passed onto the ad valorem tax or to the rate payments for the Washington Suburban Sanitary Commission.

A more realistic amount is if we would put together bonds of the other municipalities, as well as other agencies we have talked about, it probably approaches the neighborhood of $90 million in 5 years that is being absorbed by the citizens of this county.

In addition to which, it is hurting services in the country because we are simply deferring construction projects. It is not only decisions made here, but obviously, the State and elsewhere making the same decisions.

We are also hurting from loss of revenues from the business community, particularly the construction aspect of business. We are hurting from other business revenues.

This entirety is being complicated by the actual threatened cutbacks of Federal and State aid. We would ask in behalf of official and county government that the U.S. Congress do everything possible to reduce the rates.

In the meantime, we ask you to try to intervene to restrict activities that are being contemplated in areas such as the Internal Revenue Service that would limit imaginative approaches to be used by State and local government to help keep the private sector afloat at this time.

I am convinced that were it not for the intervention of State and local government in the industrial revenue bonds and other approaches that we, the private sector, would be in considerably worse shape than it is in this county.

Thank you for having us here this morning.

Senator **SARBANES**. Thank you. As I say, your prepared statement will be included in the record.

[The prepared statement of Mr. Glendening follows:]

PREPARED STATEMENT OF PARRIS N. GLENDENING

Regrettably, the subject of high interest rates has many complex components, most of which are having serious impacts on Prince Georges County, its financial resources and our citizens.

The most serious and crippling effect high interest rates is having on our county is in the area of home building activity and the high cost of mortage loans. However, I would like to confine my remarks to the impact on county government.

The most immediate reaction to today's high interest rates is reflected by the increasing rates State and local government are having to pay in the municipal bond market. This impact directly affects all local governments and the impact has been alarming. In 1977, Prince Georges County paid an interest rate of 4.99 percent on one of its construction bonds. Today, the average rate being quoted on municipal bonds is 12.5 percent. In just the past 6 weeks, municipal bond interest rates have jumped almost 2 percent.

The municipal bond market has traditionally been the primary source of capital for local government construction of roads, schools, libraries and water/sewer facilities. Since 1977, the relentless rise in interest rates has cost the citizens of our county an additional $35 million, and directly impacted their tax rates and water/sewer user rates.

This added cost of borrowing has forced the county government and many of our municipal governments to either defer construction plans or proceed, on a much smaller scale, with pay-as-you-go financing. Ultimately, these alternatives tend to increase the cost of construction and, in the case of pay-as-you-go financing, places sorely needed capital construction funding in direct competition with funding necessary for public services.

As an example of the alarming cost increase associated with municipal bond interest rates, a theoretical $1 million, 25-year bond issued in 1975 at a 6.19-percent interest rate would, over the life of the bond, cost the county $978,892 in interest. At the July, 1981 interest rate of 10.5 percent, the same theoretical bond would cost $1,865,000 in interest payments.

Other impacts from high interest rates directly affect our county's business community and eventually impact county government. For example, as the cost of commercial loans increase, the cost of plant expansion for public utility companies increases, resulting in higher utility costs. As the cost of financing business inventories goes up, so does the cost of office supplies, building materials, vehicle repair parts, and school supplies.

Higher county operating costs is not the only financial impact brought about by high interest rates. Numerous county revenue sources are adversely affected. The slump in new car sales will result in a loss of vehicle registration fees. The staggering drop in our county's building activity and housing sales will lower collections of recordation and transfer fee, as well as licensing and building permit fees. All of these areas have been seriously affected by high interest rates, however, the most devastating impact may well be in the county's economic development efforts.

During the past several years, the county has significantly increased its efforts to attract quality commercial and industrial concerns and to assist in their relocation. A major part of this assistance has been in the form of county participation in industrial revenue or MIDFA (Maryland Industrial Development Financing Authority) bond issues. These bond issues have traditionally been at lower than prime rates and demand in our county for such bond issues has been steadily growing as companies seek less costly financing alternatives in answer to rapidly rising commercial loan rates. Since 1979, the county has participated in over fifty such financing arrangements. Now, we are seeing a gradual saturation of the market as more and more local governments compete for new industry. This market saturation will eventually either lead to higher and higher industrial revenue/MIDFA interest rates in order to attract lenders or fewer and fewer such issues will be sold. Either way, the county's ability to attract new industry will be reduced, and our economic development plans will suffer.

The impact of high interest rates is not, however, confined to new business development. We all are aware of the crippling effect high interest rates have had on the building industry. Add to this problem the impact high commercial loan rates are having on existing small manufacturing and repair businesses. As the cost of borrowing money becomes prohibitive, small businesses are forced to reduce inventories, defer modernization efforts, plant expansions and new machinery purchases. In effect, they can no longer be competitive, which can result in a greater number of business failures, increased unemployment coupled with greater demands for public assistance, and loss of county revenues from business property taxes. Clearly, the ripple effects of high interest rates can impact all our citizens, and the impact can be devasting.

Senator **SARBANES**. Mr. Glendening, I know you have to leave to attend another meeting.

Let me just ask you a couple of questions, then I will go to the rest of the members of the panel. Has the deferral of construction projects, which you said has reached the point where what is being deferred are not items that can be deffered without much of a negative consequence, but items that are either very important for the further economic development of the county or important to establish the public infrastructure which the private sector required in order to carry forward its projects?

In other words, where are you in terms of the deferral of public construction projects in terms of the impact of that?

Mr. **GLENDENING**. Senator, I suggest in terms of our proposed construction list, whether we are talking about libraries or roads or mass transit system that we are long since removed from the position that we are deferring either surplus or sort of beneficial projects that are not essential. We are at the point where we are deferring projects that because of the increased costs, a number of them, I think, simply would never be constructed even as absolutely essential as they are.

Beyond that, the immediate impact is considerable. We have major areas of economic development that are simply being prohibited from development because the transportation facilities are such that it cannot have access.

Just down the road from us, at the intersection of the Beltway and Route 50 are two major projects in their development areas that potential can be minimized in the local. We have people who wish to come in there and national firms who wish to invest significant amounts of money for construction, but we simply cannot get access.

Our other real concern, as an illustration, essentially at least here, is the subway system. We are becoming increasingly convinced with the sky-rocketing costs and the deferral on construction of some of our lines that we are in danger of losing some of the lines here. The problem with that is that this is the regional compact. We have paid our fair share as other jurisdictions have constructed the lines, and we find now because of the money situation plus the total escalated cost, we may not have all of our lines. The citizens of the county think, and correctly so, that that is unfair.

Senator **Sarbanes**. I think it is, too. An agreement was reached on the Metro. It was then subjected to reexamination and in effect reaffirmed. As you know, it is my strong view that ought to be carried through as projected.

This has been helpful testimony. We appreciate it.

Mr. **Glendening**. Thank you very much.

Senator **Sarbanes**. Thank you.

Delegate Frank Komenda, would you like to go next?

STATEMENT OF HON. FRANK J. KOMENDA, A MARYLAND DELEGATE FROM THE 27TH DISTRICT, ANNAPOLIS, MD.

Mr. **Komenda**. Thank you, Senator.

My name is Frank Komenda. I am a member of the Maryland House of Delegates and have been for the past several years.

I ask your consent to have Delegate Donaldson accompany me to give part of my presentation.

I serve on the Maryland House Economic Matters Committee which deals with the entire matter of the economy and the result of the interest rates. I also serve as the subcommittee chairman of the Interest Rates Requirement Committee. And last interim session, I served as a joint committee chairman for the Economic Development Evaluation. So I have a direct interest in the matter before us today.

Delegate Donaldson serves on the Maryland House Appropriations Committee, and he will address you with regard to the impact of high interest rates on government spending.

I would like to point out that my various capacities and my direct involvement in the matter of interest rates that today, I am not here in an official capacity representing the General Assembly or as a member of any of those committees, but rather I am here as a very concerned legislator who has a great deal of concern and who by virtue of the committee assignment may have a rather direct responsibility involved in making those decisions of public policy that will have an impact on this matter in the future.

I would like to address my remarks in two areas specifically. One is that I think one of the goals of the State Legislators in The General Assembly has to be to maintain the integrity of our dual system, our dual charity system, of lending institutions. I think if we find ourselves where we provide a competitive advantage to one or the other, we are going to do a great deal of violence to our economy.

I fear that we are rapidly approaching that point with the policies of the Federal Government with regard to federally chartered institutions not being consistent with those of the State-chartered institutions.

I refer specifically to the Public Law 96-221, the so-called Deregulation Act of 1980.

While I appreicate that Congress passed this particular piece of legislation in order to deal with the problems of the economy, the national economy, in the aggregate, I am concerned about the impact that we may realize on the individual States that make up this aggregate.

For example, in Maryland, we find ourselves surrounded by States which have elected to remain in the deregulation aspect of the Act, and as such have deregulated interest rates—specifically Delaware, Indiana, Virginia, and Pennsylvania is presently considering.

Should Maryland elect to exempt out and maintain the usury ceilings within the lower general assembly, we could find ourselves as a regulated State within a sea of deregulation. I think that there is appreciation that the dynamics of the marketplace would take care of the consequences of that.

I think that, of course, is a concern. We have already seen some of our larger lending institutions either having moved their operations or considering moving their operations. So we are impaled on the horns of the dilemma of attempting to maintain a healthy economy and environment for our lending institutions to function while at the same time be able to provide an adequate source of credit to our borrowers, either business or consumers, at a reasonable price.

Finally, I think that the thought that occurs to me is that over the 7 years that I have served in the legislature, I have seen many issues, political, social, economic, where we have seen industry, labor and the consumer in different and frequently opposing positions on these. But the one issue that seems to cut across the board where there is a unanimity of the impact, be it the low-income family who is attempting to balance a budget or the giant corporation at the highest interest rate, the high interest rate problem seems to be that one common denominator that cuts across all of these social, political, and economic issues.

The interest rates in my judgment are the single most important trigger that puts the entire mechanism of cost and wage/price spiral, inflation, all of those factors into the bag.

I think as has been suggested in earlier testimony that a firm grasp on interest rates and the rest of the economy can follow suit on an orderly basis.

Senator Sarbanes, thank you for the opportunity, for giving me the opportunity, to express these opinions this morning. I congratulate you on the condition of coming out to the communities and making this available to our communities.

Senator SARBANES. Thank you.

Delegate Donaldson, do you want to speak?

TESTIMONY OF HON. DENNIS C. DONALDSON, A MARYLAND DELEGATE FROM THE 26TH DISTRICT, ANNAPOLIS, MD.

Mr. DONALDSON. Thank you, Senator.

In the State's role of financing government, we, too, have the same problem of declining revenues and increased demand for services. People simply don't have enough money to spend. The money they have goes into the house payments and car payments.

Tuition—we happen to be here in the community college—is going off the table. Loans that are available are now more difficult to obtain at a higher interest rate.

As alternatives, at the State level, we can choose not to borrow money to make capital improvements. There is a termination at this time of high interest to invest any moneys that might be lying around in the State coffers rather than borrow money.

We of necessity are looking towards cuts in hiring, if not layoffs, simply by attrition; cuts in capital improvements. If you will note, our roads are being patched rather than resurfaced. Rather than new roads being built, we are simply trying to keep up with what we have.

There is a much-needed bridge in the area of Vienna that goes into Ocean City that would have a tremendous impact on Ocean City. If that isn't cleared up, a new bridge built, the type of delay that would be faced at the State level, I think I can safely say that Maryland's State Controller, the Treasury, the Government, will not go to the money market and borrow money at exorbitant interest. Rather, we will simply live with what we have.

By law, we must have a balanced budget in the State of Maryland. So many of the alternatives that are open to the Federal Government and other States are not open to the State of Maryland. So we must play the game with the cards we are dealt. Unfortunately, in these times, it has been very, very difficult.

Those are my remarks, Senator. Thank you very much, and welcome to the 26th District.

By the way, we have the Senator and myself.

Senator **Sarbanes**. I appreciate your being here.

State Senator Donovan.

STATEMENT OF HON. B. W. MIKE DONOVAN, A MARYLAND STATE SENATOR FROM THE 26TH DISTRICT, DISTRICT HEIGHTS, MD.

Mr. **Donovan**. Good morning, Senator. Nice to see you again. I want to welcome you to the 26th District also which Delegate Donaldson and I represent in the Maryland General Assembly.

I recall the days we served together there in the house of delegates. And I welcome you to our district.

Senator **Sarbanes**. I have aged a lot since then, Mike, and you haven't aged at all.

Mr. **Donovan**. Some of us have greater problems, I guess.

Senator, the people in this area are probably pretty much accustomed to the National Government being right in their backyard. And it always amazes me to think we have a U.S. Senator with us here in our district, and this place isn't any more full than it is today. I know in Topeka, Kans., or Wichita Falls, Tex., or Tempe, Ariz., or places like that, where the Senator never arrives, it seems that it is a great day when he comes into town. And I wish it were the same way here.

I know you are interested in us.

Since your days in the general assembly, the State has been playing an increasing role in the problems of funding for local governments in Maryland. The things that have happened since you were there are these: When the Metro system first started, the Prince Georges County government proposed its initial bond issue. Since that time, the State has taken over the role of providing the funds for the capital construction and the bonded indebtedness of that Metro line.

We have done that because another system developed in Baltimore City which the State had to share a comparable responsibility for since it was all inter-Maryland jurisdictional problems with Baltomore County and Anne Arundel and Baltimore City.

The compact that developed Metro here was with the jurisdictions that were outside this State, and we had a responsibility to the citizens of Maryland to support that. So we have come in for the major portion of the funding of that Metro. We eventually took over the bonded indebtedness of that bond issue.

Another item that was causing local governments great problems because they had to float bonds in order to construct them was the school systems. We developed an Interagency School Construction Commission in Maryland that took over the construction of the public educational facilities in the entire State—all 23 counties and in Baltimore City. That put a tremendous drain on the State as far as its spending of its revenues went.

To this day, we are now taking over the bonded indebtedness of those schools that were built prior to the origination of the State program in order to assess the local governments.

One of the things Chairman Glendening mentioned was the TRIM, how TRIM was imposed by the citizens of Prince Georges County under the charter provisions to limit the amount of money that could be raised through income or property taxes. We realized that it would be a limit on that.

We developed in the State of Maryland, in order to assist the senior citizens and those citizens who were least able to pay, what we called the circuitbreaker program of property taxes. We set a limit that, based upon a person's income, they would pay only so much real estate taxes. Above that point, they would be held safe, not required to pay.

We realized that the local governments could not afford the losses that would occur if we forgave citizens taxes. So the State then stepped into the circuitbreaker program to the point that it made up to the county—held them safe—that money. And the additional money that occurred in Prince Georges County, I think it was $11 milion that the State put into the county funds in order to supplement that circuitbreaker program.

The State has been toying with the idea of a limitation on bonded indebtedness for many years for many of our capital improvement programs. I serve on the Capital Budget Committee. What have been deferred, delayed, are essential projects. We are picking and choosing between dire needs now.

It used to be we could sluff off the luxury items for a few years, but now we are down to the point of choosing between higher priority items, what to build and not to build. We are trying to set a limit of $170 million in bonded indebtedness. Each year, it slips up to $180 or $185 million based upon some priorities that come in.

But the point is that the State recognizes it cannot go on in this market today floating bond issues that are not too well received by the bond people who are buying them. And they are charging excessively high rates of interest in order to float the bonds.

So you are on the right track. The interest program cuts across, as Delegate Komenda said, all phases of the citizenry, and you are on the right track. And I commend you for these public hearings that have been held.

Senator **Sarbanes**. Thank you very much.

Governor Hughes appeared before the subcommittee Tuesday morning in Annapolis and in effect concurred with many of the observations that you all have made here this morning.

I think, Mr. Donovan, this last point is enormously important. And that is that you, both the State and local governments, as we have been hearing it, are now deferring capital projects which are very important to put in place for the private sector to be able to carry forward its projected activity.

So we are deferring a lot of things. It is not where you say, "Well, maybe it will come along some day, and in any event, we will have to make do." The deferral of those projects means that the private sector is then not able to carry forward with its investments since those investments are key to either a road or some other form of public investment that is essential to the private development which is being projected.

That is in may instances apparently being lost altogether, not simply being deferred.

Well, we thank you all very much for coming. I'm pleased to be here in your legislative district. I saw Lorna Sheahan here earlier. I think she had to slip away.

Thank you. Nice to see you all.

I think we will have the realtors' panel here next, if you gentlemen will come forward.

Gentlemen, we are pleased to have you here, We apreciate you patience and the waiting. And if you have worked out some order among yourselves, why don't we go on that basis?

If you could identify yourselves and your business or connection for the reporter so she could get that into the record, you can do that as you speak. We would appreciate that.

STATEMENT OF LEO K. FARRALL III, L. K. FARRALL, LTD., REALTORS, WALDORF, MD.

Mr. **Farrall**. Thank you, Senator.

It is a pleasure for me to speak to you on behalf of the realtors and the related business interests in the southern Maryland area. I realize that you have held these meetings in different areas of the State throughout the entire week, and I am sure that the input and response has been basically the same.

I have a group of letters, many addressed to you, Senator, from a number of buyers, sellers, mortgage companies, and also from the president of the Charles County Commissioners, that will reflect some of the problems these folks are having with high interest rates. Let me read just one of these if I may that was addressed to Congressman Roy Dyson.

Senator **Sarbanes**. And the other letters, when you submit them, will be included with the record at the end of this colloquy.

Mr. **Farrall**. Thank you.

The letter reads:

DEAR SIR: I am writing to you as a very concerned homeowner. A few years ago, I built a large home in Southern Maryland, realizing at the time that I would only be here approximately 3 years. Of course, I anticipated that at the time I would be relocated, I would be able to sell my house.

Due to the extremely high interest rates, this does not appear to be possible in the foreseeable future. Something must be done. Consider for a moment what has always been the basis of strength of America with the family built around the pride of ownership in the family home. This will not be possible for our young people of today.

Just a few years back, a person could qualify for a home loan approximately three to four times his annual income. Today, the number is between 1½ and 2 times. This is strictly because of the exorbitant interest rates.

What happens if people are unable to buy homes? The home construction falls off, the real estate business drys up, the people are out of work, and the economy of the country goes to pot.

Is this what your government and the economic advisors want? If so, they are doing a wonderful job. If not, something better be done about interest rates and done quickly. I along with countless others have invested my earnings in a piece of America, a family home. To be severely penalized for this action is unthinkable.

Interest rates must come down for the good of the country and the individual rates must come down now. A very concerned homeowner, Robert Tulk.

Now, I would like to relate to you the effect of these high interest rates on my company, L. K. Farrall, Ltd., Realtors, located in Waldorf, Md. My company—and I consider myself a small business person—is 27 months old this month, starting in March 1979.

We experienced good growth in 1980, and a relatively steady market has helped us to continue our business through the first half of 1981. However, the last few months have been steadily downhill.

I'm sure you have been brought abreast this week on the percent decline of real estate sales in the State. You should also know that the Southern Maryland Multiple Listing Service which comprises Charles, St. Mary's and Calvert Counties, in the month of August, experienced a 35- to 40-percent decline in sales. This decline in sales is directly in proportion to my company's records which also had a 40-percent decline in the month of August.

If the interest rates which we are experiencing today continue, it is my opinion that approximately 30 percent of the firms in the southern Maryland area—realty firms, that is—which would be approximately 300 people—would not be in business in September of 1982.

I employ a full-time staff of six people and have associated with me 40 licensees. A number of my agents are already talking about other careers and/or jobs. And within the next 30 to 60 days, if the market does not improve, I will have to make some drastic decisions about my full-time employees. This is how the interest rates are affecting me personally in my business.

And I am sure that you have heard and you appreciate how these rates are affecting the buying and selling public.

It was reported this week that home prices have fallen for the first time in 40 years. There were 3,300 small businesses that declared bankruptcy in the Washington Metropolitan area in the first 6 months of 1981. Interest rates are having a chaotic effect on our entire Nation, and I hope that Washington will begin to become more sympathetic and attune to the problem. And it is a complex problem.

I would hope that you and our other elected officials from Maryland continue to support the All-Savers Certificates that will become effective on October 1; that you will work to hold the budget commitments as they have been voted on and reduce them if possible. And possibly, you can have some effect on Paul Volcker and his committee to relax money growth targets at the Federal Reserve.

I appreciate your interest. Thank you.

[The letters referred to by Mr. Farrall follow:]

COUNTY COMMISSIONERS,
La Plata, Md., September 3, 1981.

Hon. PAUL SARBANES,
U.S. Senator,
Washington, D.C.

DEAR SENATOR PAUL SARBANES: Home ownership is an extremely important factor to both the stability of local government and to the stability of a community. Home ownership allows us to have a more dependable base of citizen involvement and a greater commitment from the citizenry with regard to their role in the community.

High interest rates are preventing many Americans from attaining their dream of owning a home. Many of our citizens are forced to rent instead. Oftentimes the rental unit, if recently constructed, has a high monthly rent payment because to build the unit the landlord was forced to borrow money at a high interest rate. This makes it difficult for people to save enough for their down payment. If interest rates were lowered more people could better afford to own their home.

Please pursue whatever avenues that are at your disposal to help Americans attain this dream of home ownership. It is important to us all.

Sincerely,

ELEANOR F. CARRICO.

THE BARLEY CO. INC.,
Waldorf, Md., September 2, 1981.

Hon. PAUL S. SARBANES,
The U.S. Senate,
Washington, D.C.

DEAR SENATOR SARBANES: Thank you for your support of the Economic Recovery Tax Act of 1981. The All-Savers Certificate amendment contained in this bill will assist the housing industry by making available more funds for mortgage financing.

We must, however, not stop here. The budget cuts proposed by the Reagan Administration will lessen the competition for funds in the marketplace. Current spending levels and debt financing have kept the pressure on record high interest rates. The spending targets for the next three years should be held firm or reduced to achieve a balanced budget by 1984.

In addition, a return to the dual system of controlling interest rates as well as the money supply would provide more stability in the financial markets. Simply controlling the money supply has caused an excessive fluctuation in rates. Relaxing growth targets along with consistent interest target rates would ease these fluctuations.

We appreciate your concern for the problems facing housing. Your consideration of the above proposals would help solve some of these problems.

Sincerely,

DENNIS R. VAIRA.

BANCO MORTGAGE CO.,
Waldorf, Md., September 2, 1981.

Senator PAUL S. SARBANES,
U.S. Senate, Joint Economics Committee,
Washington, D.C.

DEAR SENATOR SARBANES: I am writing on behalf of my company, Banco Mortgage Company, with regard to the current economic situation pertaining to real estate financing.

Banco Mortgage Company is one of the nation's larger lending institutions for mortgage loans. We are currently located in Baltimore, Montgomery and Charles Counties.

Our business consists solely of financing home loans under various government agencies such as the Veterans Administration, Federal Housing Administration and the Federal National Mortgage Association.

The current level of interest rates has made it extremely difficult for us to grant loans to perspective home purchasers. We are finding that most purchasers are reluctant to close with rates at their most recent level.

We have experienced a decrease in our production of over 50 percent from this time last year. Needless to say, the effect of this decline of our business makes it imperative to correct this situation.

Banco Mortgage Company employs over 50 people in our three Maryland offices. The current level of production may force us to reduce the size of our staff.

We feel this has created a need for emergency action on behalf of Congress to introduce new methods which will enable our residents to purchase a home of their own.

Your favorable action is requested and sincerely appreciated.

Yours very truly,

STEVEN D. LOWE,
Assistant Vice President.

WALDORF, MD. *September 2, 1981.*

Hon. PAUL SARBANES
U.S. Senate,
Washington, D.C.

DEAR SIR: I am not one who complains a lot, however I think it is time something is done about the High Interest Rates.

I have two married children and know of many more who would like to own their own home and fulfill the American dream of owning their own. To own one now is out of the question.

As for myself, I retired last year anticipating a move to Florida after selling my home in Maryland. I purchased a home in Florida with the contingency that I had sold my home by Aug. 15, 1981. Our home here as of now has not been sold. We are not asking an unreasonable price and we do have a well kept house but with the High Interest Rates we have very few people even looking.

In view of the present economy I have sacrificed one cost of living raise each year and I will now be unable to collect the minimum Social Security as I have all my quarters paid in. I would like to spend my declining years in a more moderate climate and do to health reasons plan the move to Florida. Thank you for your consideration and for anything you can do to ease the problems due to the High Interest Rates.

Sincerely,

JAMES H. GREEN.

LA PLATA, MD., *September 2, 1981.*

Hon. PAUL S. SARBANES,
U.S. Senate,
Washington, D.C.

SIR: We respectfully request that you and your colleagues enact legislation without delay to revitalize the home mortgage industry.

For what it is worth, we are among the legion of your constituents who are faced with the necessity of moving. Our house has been on the market since early May, listed at its VA-appraised price. We have yet to receive a firm offer because we can present no below-market financing. This, despite the fact that the house is universally judged to be a quality dwelling with a reasonable pricetag.

Your assistance in returning home mortgage interest rates to a reasonable and workable level would be very much appreciated.

Very truly yours,

FEDELA R. VINCENT.
ROBERT J. VINCENT.

Tri-County Federal Savings
& Loan Association of Waldorf,
Waldorf, Md., September 2, 1981.

Hon. Paul S. Sarbanes,
U.S. Senate,
Washington, D.C.

Dear Senator Sarbanes: I am writing today to request your support for a recovery plan to benefit the depressed housing and thrift industry.

As president of a Federal savings and loan, I have first-hand knowledge of the devastation wrought by government efforts to deregulate an important sector of our economy.

The sudden lifting of ceilings on deposit rates, without consideration of how these rates are to be paid, has put our thrift industry on the verge of destruction. It is the savings and loans who have approximately 90 percent of their assets in fixed mortgages, not the banks or money market funds!

Our program for recovery consists of several key points. I'll list these for you review.

1. The new tax-free certificate will have to be guaranteed a life greater than one year. No organization is going to commit long-term lending programs to a one-shot, one-year gimmick. Make the certificate program last for five years.
2. Money market funds need reserve requirements and investment criteria. They act like financial institutions without the responsibility.
3. The Federal deficit must be curbed. It is absorbing the household sector's funds at an alarming rate and setting interest rate records.
4. The targeted growth of the monetary base must be relaxed.

We, the thrift and housing industry, are not asking for a "bail out". Sensible legislation will permit the competitive forces to take over without the severe economic disruptions witnessed in the last eighteen months.

Yours truly,

Michael L. Middleton, *President.*

LaPlata, Md., September 3, 1981.

Gentlemen: As a builder in the Southern Maryland area, I am deeply saddened and concerned as to the way the Federal Government has stopped the construction industry. It is putting many hardships on workers that are no longer needed, and are laid off with no other profession or job to go to.

As a voter, I voted republican to fight high interest rates. They have been constantly higher since the election. We in business feel betrayed. Our company is used to building 75 to 100 homes per year. In 1980 we built 32 homes, and so far in 1981 we have built 8. These are in the $80,000.00 to $95,000.00 range. The industry has been very hard hit, and the real reason for the inflated cost in living for housing lies directly with the Federal Government, citing the following:

High interest rates = Higher money cost. This is added to the house price, money buy down up to 10 points, this is added to price of the home. We are talking of up to $14,000.00 added cost per unit of which the consumer pays. This is extremely inflationary, and for this he gets not one nail.

We are barely able to hold on, and it seems such a shame that such a great nation would let this happen, while all the fat cats in Washington worry about their personal raises, fine homes for themselves, and private schools for their children. I can see a big change in 1982 coming. Here is one democrat who wonders if he really made a mistake. I would like to know how many more there are.

Construction is jobs for lumber men, masons, carpenters, steel, auto, heavy equipment, painters, electricians, drywall, concrete, roofers, to name few. These people working keep our shopping centers, offices, and *you*, all working.

Thank you,

Milton F. Hein, Jr.

Jackson Real Estate Co., Inc.,
Waldorf, Md., September 3, 1981.

Dear Senator Sarbanes: I am deeply concerned with the very serious problem of high interest rates and how it is hampering or better yet, choking my existence as a small business proprietor and a real estate salesman.

A few years ago upon selecting real estate as a career, I was so very proud of the fact that at last I found a profession suited to me as well as the independence it affords me, but for two years now I have waited and watched patiently as the real estate market declined and through it all a prayerful hope that there are intelligent people in our Government with steadfast determination and common sense to lead us out of our crisis. That hope has not diminished.

Senator Sarbanes, I humbly beg you, please fight to ease high interest rates. Give us a chance to work in our chosen field to support ourselves as well as the existence of those who depend on our success!

Respectfully,

SUSAN JACKSON.

JACKSON REAL ESTATE CO., INC.,
Waldorf, Md., September 3, 1981.

Hon. PAUL SARBANES,
Senate Office Building,
Washington, D.C.

DEAR SENATOR SARBANES: I am writing to you as a distressed American Citizen and a troubled Real Estate Broker.

I have been in the Real Estate business for over 10 years. I am a dedicated person and feel that I have been of great service to a great many people and have helped many people carry out the "American Dream" of home ownership. I have been through bad times and have been able to overcome many obstacles, but the present state of affairs are beyond anyone's control except our Government and the Federal Reserve Board.

I understand what the Government and the Federal Reserve Board is trying to do and I fully agree with it. I don't agree to carrying things to a point of destroying small businesses, and making it almost impossible for a person to buy or sell a home. I am watching builders, mortgage brokers, Real Estate Companies, Title Clerks, suppliers, etc. either going out of business or going bankrupt. I can't help wonder how long I will be able to stay in the business that I am dedicated to and qualified for to make a decent living.

We need your help and we need it now. Interest rates must come down so that a person that wants to work and better themselves and have home ownership has the opportunity to do so.

Sincerely,

JUDITH MATTIA.

MD. QUALITY HOMES, INC.,
La Plata, Md.

DEAR SENATOR SARBANES: We have been in the building and land development business for 18 years, but today's interest rates have put a complete stop to our business and many other businesses.

If the interest rates are not soon dropped to a reasonable amount, the banks will be in the land and housing business and no one will be able to afford to buy from them either.

It's hard to understand also why the United States loans billions of dollars to foreign countries and charges little or no interest.

These rates must be lowered in order for our people to get back to normal productive living.

Very truly yours,

KENT CHADWICK.

BRISCOE, KENNEY & KAMINETZ,
Lexington Park, Md., August 31, 1981.

To Whom It May Concern:

My waterfront home in Hollywood, Maryland has been listed and on the market for sale for approximately ten months. It is my considered opinion that the most significant factor in preventing the sale is the unprecedented interest rates available to homebuyers.

Very truly yours,

JOHN HANSON BRISCOE.

NEW ADDRESS REALTY INC.,
Charlotte Hall, Md., September 1, 1981.

DEAR SIRS: I am enclosing a list of Buyers and Sellers to whom, because of the rapid rising interest rates have been either unable to purchase a home or in some cases, in fact quite a few, sell their property.

Many potential buyers are out there looking for their first home and finding that even an inexpensive home in the $40 to $50 thousand range is completely out of their ability to pay for.

All of these cases were directly related to interest changes or points on the part of the sellers.

These are only cases that fell apart because of this problem and not any cases where the purchaser did not qualify at the original interest rate.

Purchaser	*Seller*
Sperlbaum	Kravats
King	Whitson
Obrinski	Dennis
Brown	
McInerney	
Hershey	
Jones	
Lindsey	

These are all within the last 7 months and do not reflect any cases before that with the exception of the King's.

Respectfully Yours,

LEA HUTCHINSON,
Realtor Associate.

NEW ADDRESS REALTY INC.,
Charlotte Hall, Md., August 31, 1981.

DEAR SIRS: I am writing this letter to try to show you an example of what rapid rising interest rates are doing to my profession not to mention the middle income people of this country.

These people became victims of circumstance beyond their control, and are paying a very dear price. I am enclosing my personal notes as to what transpired in this case.

In essence what happened is that we ended up going to court over this transaction. It was a most unfortunate experience, the courts found in our favor, so besides not being able to purchase the home they wanted, these people are faced with a judgment against them.

The notes show a 13½-percent rate which by the time we should have settled was actually 14 percent reflecting a difference of $125.15. To a man with 4 children to feed this is really a heavy load.

There should be some way to control this market enough at least keep the interest commitment long enough to settle the property at some where near the interest rate they qualify for.

This is just one case I am writing about, believe me there are many more. It is getting to the point where the dream of owning your own home is the impossible dream to the majority of middle class Americans.

Respectfully Yours,

LEA HUTCHINSON.

OFFICE NOTES ON KING/MAGIC, CONTRACT DATED MAY 25, 1980

July 12, 1980: Frank Baker took key and started pump on well at 1600 Ann Circle. The water was run for 6 hours for 2 days in a row for the water test order July 10, 1980.

July 15, 1980: Water sample was taken.

August 1, 1980: Report of ground contamination was reported from Health Department.

August 2, 1980: Well treated.

August 4, 1980: Lea Hutchinson requested a pre-occupancy for the King's as they would lose their points on the home they were selling August 9, 1980. Phyllis called back with permission the same day.

August 11, 1980: Kings moved in. The air conditioning had been installed the day before, the appliances (stove) was not hooked up so Lea Hutchinson asked John Kalbasky to hook it up and it was done that day.

August 27-29: Phyllis called and asked to set settlement before points rose again. Mr. Baker said tentative for that Friday August 28, 1980. We had still not received results of water sample test. Mr. Baker called around 4 p.m. and that there was ground water contamination again.

September 2: Mr. Copsey again treated the well. Fred Pumphrey notified Ronco that the King's would settle if Magic would escrow $8,000 for well. Al Shoemaker of Colonial Mortgage, told us that FHA would not allow that. King's wanted rent reduced to $350.00 per month until the well was taken care of. Offer was rejected.

Mrs King was always concerned about the interest rate going higher. She stated several times that if the interest rate reached 13½ percent they could not afford the payments. Amount of the increase from 11½ percent at $619.55 to $705.00 PI at 13½ percent reflects an increase of $86.45.

September 26: Well failed again.

September 30: Mrs. King told Lea Hutchinson that the neighbors had told her that the well was broken by previous owners. I notified Phyllis at Runco. I also told Mrs. King that there was no need to mention that fact to me as the selling agent or to them as purchasers since Patuxent pump and well had serviced the well and Mr. Runco had every reason to believe that the well was in good condition.

October 3: Copsey treated the well again, Lea Hutchinson witnessed the treatment personally. 4 gallons of Chlorox was used.

October 16: Water sample taken.

October 23: Ground water failed again. Called Phyllis at Runco and notified them.

October 25: Called Phyllis at Runco and notified them.

October 29: Phyllis at Runco called and told us that they had ordered Patuxent Pump and well to fix the well.

November 1: Mrs. King expressed a desire to get some other type of rental agreement. She expressed a desire to settle on the house continually, but was concerned with the amount needed at settlement to pay rent and what the interest rate would be. After the well failed on October 23rd, we set meeting for November 1st, with New Address Realty's broker. Mrs. King requested a representive from Runco or Magic to be present. Mr. Runco told Mr. Pumphrey that it was not necessary.

November 1 meeting: Mr. King was very atimate that Runco or Magic was to blame for all the delays. He insisted that the well was not properly fixed and the Runco or Magic should have done something sooner. Mr. King got very nasty and beat on the table and used terrible four letter words. Mr. Pumphrey ordered him out of the office.

November 3 or 10: Mrs. King gave Lea Hutchinson an agreement her attorney drew up. Lea called Phyllis and read it to her on the phone—she was out on Monday so Lea talked to her Tuesday. We forwarded copies of agreement to Runco on the same day. Magic rejected the agreement.

November 14: The water sample was taken again. It was ordered October 29th and again November 3rd. On November 20th, Diane Davis, our secretary, was notified that the well failed again by Mr. Forlifer of the Health Department, he wanted to take the next sample from inside the house. On the 21st I called the Health Department at that time I was told that there was fecal contamination. I immediately notified Phyllis and she notified Magic. At the time I called Mrs. King at work and notified her. I also called the house to notify her children not to drink the water.

For 3 weeks prior to finding out about the fecal contamination the King's children and Mr. King had been ill. Lea suggested the family go to their doctor and have blood samples taken. Mr. Pumphrey also agreed to this. Monday November 24th Patuxent Pump and Well again treated the well. December 1st sample ordered. I called Mrs. King and requested copies of the letter from her doctor.

December 3: We received Mr. Pelisses letter and contacted Mr. Runco. At 4:40 that day he called back after speaking with the Magic represFentive. They wanted to collect November rent and no more. They also agreed to put in a new well if the water sample was bad again and to pay for bottled water for them to drink.

December 4: Lea called Mrs. King and she said that she would talk to Mr. King and let her know if acceptable on December 5th.

December 5: Phyllis called Lea. I called Mrs. King. Mrs. King said they were not going to accept the proposal and would look for a rental house. Lea told her that the letter from Mr. Pelessie made no reference to the pre-occupancy agreement and that could be held accountable for the pre-occupancy agreement. Mrs. King said she would not be held to the agreement. Mr. Pumphrey also notified her to the affect later that day. Mrs. King told him to talk to her attorney. Mr Pumphrey then notified Mr. Runco and I mailed copies to Mr. Runco.

California, Md.

DEAR SIR: I have been trying to sell my house since January, and, because of the high interest rates, I can't sell it. I have lowered the price 10 percent, and still, no interested family can qualifey for a loan. Please do what you can to bring the interest rates to a fair level.

Sincerely,

M. A. BARLEY.

CENTURY 21/RAY RANCO REALTY, INC.
California. Md., August 31, 1981.

DEAR MARY LYNN: Our home at 106 Pine Needle Court, California, Md. has been for sale since November 1980. Since that time mortgage interest rates have steadily increased from 14 percent to over 16 percent. My house is attractive, well-built and maintained, and offered at a fair price. I can only assume that the steady increase in mortgage interest rates has deterred potential customers and my ability to sell this property.

I view this situation with concern and seek your assistance on this matter.

Sincerely,

MICHAEL S. BREWER.

Senator **SARBANES**. Thank you, sir.

Why don't we hear from the rest of the panel.

STATEMENT OF THOMAS A. CARDACI, OWNER, ALL PRO REALTY, AND SECRETARY, PRINCE GEORGES COUNTY BOARD OF REALTORS, UPPER MARLBORO, MD.

Mr. **CARDACI**. Thank you, Senator.

I have two exhibits which I would like to go over after presenting my testimony.

My name is Tom Cardaci. I am the owner of a real estate company in Upper Marlboro, Md. in business since 1974. Currently, I am secretary of the Prince Georges County Board of Realtors.

Senator Sarbanes, I would like to thank you and your committee for the opportunity to speak on the devastating effects the high interest rates are having on the real estate industry. I would like to show by example how this industry has been crippled.

One, persons wishing to purchase homes are having a very difficult time unless they have a substantial amount of cash to assume a loan or some other means of creative financing or have a very, very high salary to qualify for a loan.

Two, persons wishing to sell a home have little chance selling unless they can give owner financing, have an assumable existing loan or are willing to take a large reduction in the sales price.

Three, builders have been a substantial part of our real estate activity in the past, but rates being what they are, the builders' business has virtually come to a standstill. Two builders whom we represented in 1980 have ceased building in 1981, yet one has 164 finished lots, and the other with 250 lots, both with streets on grade and utilities in place.

Carrying costs are tremendous and excess costs must be passed on to the consumer in order for these builders to survive should they be able to start building again.

Four, lenders are a dying breed as very, very few homes are sold with new mortgages due to the difficulty in qualifying purchasers. Only the few lenders allowed by law or by quirk in the law who can offer wrap-around mortgages seem to be doing business of any quantity. The ARM's, VRM's, SAM's, and other funny acronyms are not the answer.

Five, real estate brokers and agents who have survived thus far into the high interest rate crisis have done so by creative type financing. As you can see by my exhibit 1, only 30 percent of my company's settled transactions for the first 8 months of 1981 were financed with new loans. This is very small by comparison to the 83 percent of new loans in financing in 1976, 84 percent of the financing in 1977, 87 percent in 1978, and 72 percent in 1979.

In closing, I would like to say the time for the high interest rate crisis to end is now. In July alone, 11 real estate companies in Prince Georges County closed the door; in August 5. I'm sure equal numbers of builders and lenders did likewise. Sellers and buyers have suffered long enough, too. I sincerely hope your subcommittee, your fellow Senators, Members of the House, and the administration can help.

Over-the-counter remedies are no longer helpful. What we need is professional prescription which I hope your committee can begin to fill.

Senator, I have prepared two exhibits. The first one, exhibit 1, is from January of 1975, through August of 1981. It is a graph showing the percentage of homes we have sold, using financing. These are actual figures.

In 1975, 72 percent of our selling transactions were new financing. In 1976, 83 percent. In 1977, 84 percent. In 1978, 87 percent. In 1979, 73 percent. In 1980, 52 percent of our business was new loans, meaning 48 percent was creative financing, cash, assumable loans, et cetera. In this year, through August of 1981, only 30 percent of our settled transactions were new financing.

The last exhibit, what I have done is to prepare a chart of a typical financing of a $70,000 VA or FHA loan. And I have based this on a husband and wife and two children with approximately $150 plus other debts.

If we can look at the left column, Senator, at 16½ percent, that is what it would take to qualify for a $70,000 loan should you be able to find such a house. At 16½ percent, the principal and interest payment alone would be $969.60. If that were an FHA loan, it would be plus one-half of 1 percent.

The taxes are estimated at $100, insurance at $20, meaning the total principal and interest and taxes and insurance payment on a 16½-percent loan would be $1,089.60.

To qualify—I will skip down—we come down the chart to a family that would need a net income of $26,500 after taxes or a gross income of $40,000.

Going down the list, if we went to 14½ percent, a family of 2, based on the same $70,000 VA or FHA mortgage, 14½ percent would need an income of $37,000.

And down to 12½ percent, they would need an income of $34,000.

Even though the difference between 12½ and 16 is only $6,000 in income, that $6,000 would weed out about 30 to 35 percent of the people that could afford a home, $70,000 home at 12½ percent.

That's all I have to say, Senator. Thank you.

Senator **SARBANES**. Thank you very much.

[The exhibits referred to by Mr. Cardaci follow:]

EXHIBIT 1

Percentage of Homes Financed With
New Mortgages

(Actual Figure From Realty USA/All Pro Realty
From January 1975 through August 1981)

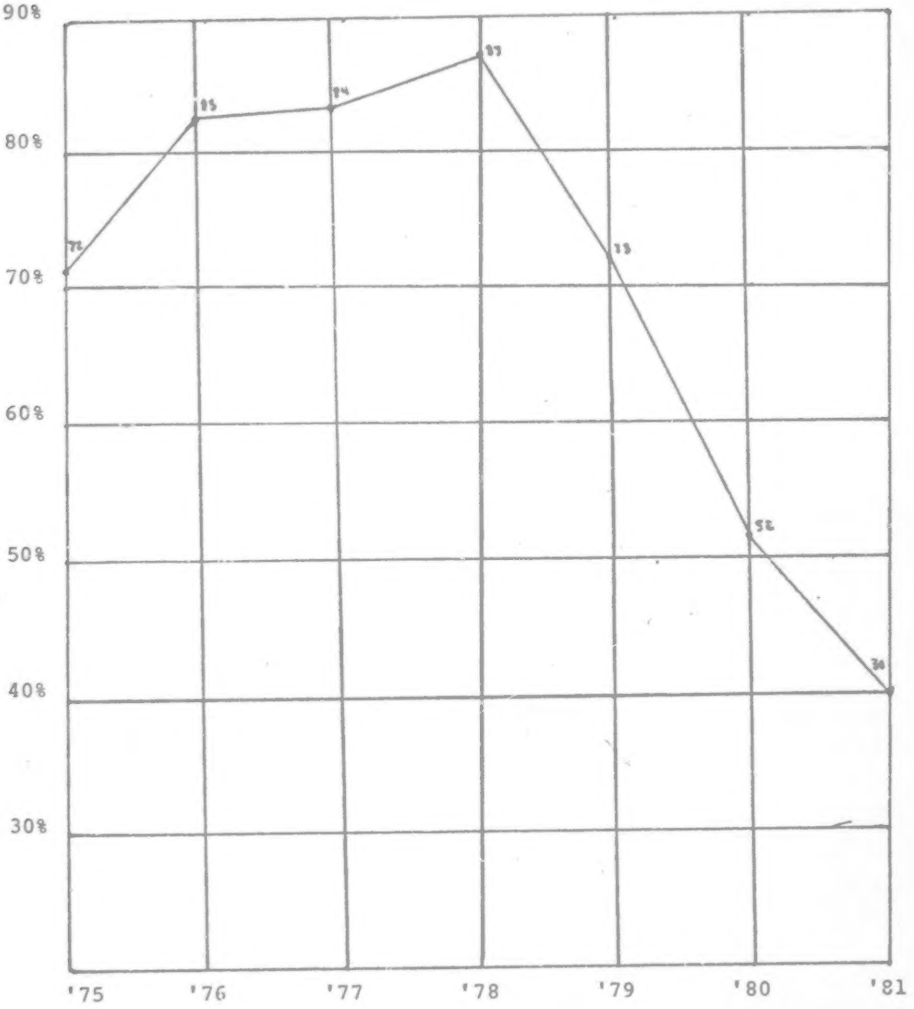

Exhibit 2

Estimated Qualifications for $70,000.00 VA or FHA loan at various intrest rates. Based on Husband, Wife 2 Children and $150.00 plus other debts.

	16½%	14½%	12½%
Principal & Intrest	$969.60	$857.19	$747.08
Taxes	$100.00	------	-------
Insurance	$ 20.00	-------	-------
	$1,089.60	$977.19	$867.08
Family Support	$700.00	------	-------
Debts	$150.00	------	-------
Utilities	$100.00	------	-------
Maintance	$ 30.00	------	-------
Cushion	$100.00	-------	-------
	$2,169.60	$2,057.19	$1,947.08
	x 12	x 12	x 12
Net Income	$26,500.00	$24,700.00	$23,400.00
Gross Income (Approx.)	$40,000.00	$37,000.00	$34,000.00
Mo. Gross	$3,333.33		
State Tax	$- 212.13		
Fed. Tax	$- 738.10		
Soc. Sec.	$ -164.59		
	$2,218.51		
	x 12		
	$26,622.12		

Senator SARBANES. Mr. Waggoner.

STATEMENT OF JAMES H. WAGGONER, REGIONAL VICE PRESIDENT, MERRILL LYNCH REALTY/CHRIS COILE, INC., AND MEMBER, MARYLAND ASSOCIATION OF REALTORS AND THE NATIONAL ASSOCIATION OF REALTORS, BOWIE, MD.

Mr. WAGGONER. Thank you, Senator. I appreciate the opportunity to meet with you this morning.

I have a prepared statement from which I would like to digress briefly.

Senator SARBANES. Fine. We will include the prepared statement as submitted in the record.

Mr. WAGGONER. A fundamental material need of the American family is to have the ability to own its own home, thus providing shelter for the family and creating a sense of purpose in day-to-day endeavors.

The existence of double-digit inflation over a period of years has dictated the necessity of redefining our priorities as a nation. We can redefine our priorities, not the needs of our families.

We in the real estate industry witness first hand the lost dream of homeownership. To those families who cry, "I can't afford it," we would hope that the position of the administration and Members of Congress is not similar to that of Marie Antoinette, "Let them eat cake."

Prince Georges County Board of Realtors reported 617 sales during July 1981, down 39 percent from the July 1980 sales figure of 1,015. In the first 7 months of 1981, Prince Georges County Board of Realtors reported 4,852 sales compared to 5,302 sales for the same period 1 year ago, a decrease of almost 10 percent. Bear in mind that Prince Georges County offers the most affordable housing in the Washington metropolitan area.

The present situation is obvious; we must seek answers.

Respectable real estate companies which have served the local community well are closing their doors and will be forever lost to our economy and way of life.

As a regional vice president of Merrill Lynch Realty, I am fortunate to be a part of a large company. Although our sales locally are up 27 percent, area home sales are down almost 40 percent. Real estate companies call us daily attempting to sell their organizations—smaller companies. We still have strong competition, although sincere, dedicated, professional realtors and realtor associates have left our profession due to financial and emotional stress.

I would like to mention a real estate company that I founded in 1973 and sold 2 years ago. Heritage Realty closed its doors last month, overnight. The principles of the organization were left with some obvious negative financial situations as well as myself in that I had an extended buy/sell agreement. Many associates were on the street without a company.

And more importantly closing Heritage Realty left several million dollars worth of real estate with no real estate company.

Now, fortunately, that situation worked itself out through some efforts of Merrill Lynch and the principles of Heritage at that time. I will have to say, though, it would have to be discouraging for a homeowner who had his home on the market with a real estate company one evening to find the next morning that the company is no longer in existence when his move or financial welfare is dependent a great deal on the sale of his home.

The National Association of Realtors, consisting of 750,000 members lost 70,000 members over the period of this realining economy. Yet, as an association, we remain optimistic and have faith in the governmental process.

The real estate field is entering its third year of the impact of a down economy. A realining of the economy is not necessarily bad. We endured this type of situation in 1969, 1973, and 1974, although not to this extent. Sister industries such as mortgage companies, settlement attorneys, appraisal companies, home inspection and termite companies, lenders, private mortgage, architects, builders, and insurers, are also being staggered by the continued high interest rates.

The prices of homes continue to climb—14.5 percent in Virginia, 7 percent in Prince Georges County, and 12.7 percent in Montgomery County. It is obvious that the continued escalation of interest rates will not remedy this situation.

In 1978, approximately 22 percent of a family's income was needed to provide shelter. Today, 37 percent of a family's income is needed to provide shelter.

We congratulate the administration and Members of Congress for providing strong leadership and request that one aspect of the tax program, the All-Savers Certificate, receive your continued support. The certificate should certainly help the real estate industry and commercial banks recover from staggering losses.

Personally, I would like to thank you because I realize you supported that amendment.

Senator **Sarbanes**. Yes, I did.

Mr. **Waggoner**. The administration and Members of Congress have taken bold steps to correct the inflationary spiral of our economy which have for the most part been well received by the American public. Is the continued unbearable crush necessary? neither the real estate industry nor the strong American public can withstand continued financial and emotional drain with no relief in sight.

The time to lower the interest rates would be at this time. It is difficult to watch an industry to which you have dedicated your professional life being brought to its knees. I think that the public will suffer in the long run for some of the people who are leaving real estate today. I have to cite one example.

I spoke with a realtor Wednesday evening, a gentleman and competitor I have respected over many years. I have competed for 10 years in Prince Georges County with this individual. Even though we compete, we are friends and compete on a friendly basis. He has all the professional designations we have from the National Association of Realtors: a certified residential broker, certified residential specialist, and a graduate of the Realtor Institute of Maryland. He is leaving real estate after donating 10 years to working with the community. That is sad.

We feel that we have learned our lesson in economics, and we would like to call a recess to the current situation.

Thank you.

[The prepared statement of Mr. Waggoner follows:]

PREPARED STATEMENT OF JAMES H. WAGGONER

An American Dream

A fundamental material need of the American family is to have the ability to own their own home; therefore, provide shelter for their family which creates a sense of purpose in our day to day endeavors.

The existence of double digit inflation over a period of years has dictated the necessity of redefining our priorities as a Nation. We can redefine our priorities, not the needs of our families.

We in the Real Estate industry witness first hand the lost dream of home ownership. To those families who cry "I can't afford it," we would hope that the position of the Administration and Members of Congress is not similar to that of Marie Antoinette "Let them eat cake."

Prince George's County Realtors reported 617 sales during July, 1981 down 39 percent from July, 1980 sales figure of 1,015. In the first seven months of 1981, Prince George's County Realtors reported 4,852 sales compared to 5,302 sales for the same period one year ago—a decrease of almost 10 percent. Bear in mind Prince George's County offers the most affordable housing in the Washington Metropolitan area.

Existing nationwide sales have declined 47 percent in the last 2 years making it the largest and longest drop in our lifetime.

The present situation is obvious, we must seek answers.

Respectable Real Estate Companies which have served the local community well are closing their doors and will be forever a loss to our economy and way of life. As a Regional Vice President of Merrill Lynch Realty, I am fortunate to be a part of a large company, although our sales locally are up 27 percent, area home sales are down almost 40 percent. Real Estate Companies call us daily attempting to sell their organizations. We still have strong competition, although sincere, dedicated, professional Realtors and Realtor Associates have left our profession due to their financial and emotional stress. The National Association of Realtors consisting of 750,000 members has lost 70,000 members over the period of this realigning economy. As an Association we remain optimistic and have faith in the governmental process.

The Real Estate field is entering it's third year of the impact of a down economy. A realigning of the economy is not necessarily bad. We endured this type of situation of 1969 and in 1973, and 1974, although not to this extent. Sister industries such as Mortgage Companies, Settlement Attorneys, Appraisal Companies, Home Inspection and Termite Companies, Lenders, Private Mortgage Insurers are also being staggered by the continued high interest. The prices of homes continue to climb 14.5 percent in Virginia, 7 percent in Prince George's County, and 12.7 percent in Montgomery County, therefore the continued escalation of interest will not remedy this situation.

In 1978 approximately 22 percent of a family income was needed to provide shelter. Today, 37 percent of a family's income is needed to provide similar shelter.

We congratulate the Administration and Members of Congress for providing strong leadership and request that one aspect of the tax program, the All-Saver Certificate receive your continued support. The certificate should certainly help the Real Estate industry and commercial banks recover from staggering loses.

The Administration and Members of Congress has taken bold steps to correct the inflationary spiral of our economy which have for the most part been well received by the American public. Is the continued unbearable crush necessary? Neither the Real Estate industry nor the strong American public can withstand continued financial and emotional drain with no relief in sight. The time to lower the interest rate is now!

Senator **SARBANES**. Thank you. Thank all of you for your helpful testimony.

Mr. Cardaci, I saw the exhibits you submitted.

Mr. **CARDACI**. Yes, sir.

Senator **SARBANES**. Could you categorize either for 1980 or 1981 the financing that is done, I think you used the term, some sort of creative way? Is there some way that rough percentages would indicate the different kind of created ways you are talking about?

Mr. CARDACI. I would way, Senator, the bulk in 1980 were assumptions which allowed people with a substantial amount of cash or investors—I almost went and did a percentage of these, say, 48 percent in 1980 that purchased homes through creative-type financing. Probably half of them were investors.

So it was a whole lot of people that were penalized from buying a home to live in. There were a couple toward the tailend of 1980 which was a wrap-around mortgage which is a form of a second trust where a lender comes in and puts up the additional cash needs over and above what the purchaser would have, but instead of cash form with the usual limit of, say, 16 percent, they can deal right now—they are trying to deal—20 percent.

But it was a fair amount of wrap-around mortgage toward the tail end of 1980.

In 1981, 70 percent of the creative financing that was used, I would say, was propbably 50-50 between creative financing—I mean between assumptions and wraparounds. There were a couple instances where we had to use what we call the "land installment contract" which from buyer/seller/realtor/attorneys was very, very scary.

And what I would call a last resort when a buyer or a seller is a crisis situation. And it is what you absolutely use in the last resort, lay the cards on the table, that they are playing with fire.

Senator SARBANES. This is directed to all three of you: When some sort of creative financing is used, particularly where the owner is involved is it reflected in a higher cost to the house?

In other words, in trying to take; the edge off the interest rates to help the buyer, the seller transmits part of that back into the price of the house. Housing costs then go up as a consequence of the interest rate, the financing techniques, which are open.

Mr. FARRALL. I think we may have seen that in one period of time, as a matter of fact with some of the assumptions. We are to a point in time now where the assumptions are gone; there are no more.

What we are seeing now, for example, we sold a house last weekend that had been on the market for $135,000 for 17 months. The people accepted a contract of $120,000.

It was just reported this past week, I think by the homebuilders, the chamber of commerce, that home sales are now decreasing. And this is the reason for it.

Mr. CARDACI. Senator, in response to that, two examples. We deal in a community which has *x* number of houses, but several of the same style. An appraiser came to me a couple weeks ago and told me the house he had appraised and asked what I thought it would be appraised at.

And he said: "Let me give you some parameters. The first trust on the house was $95,000, VA assumable at 9½ percent. The house in reality was probably worth $105,000."

And off the top of my head, I said it probably would have been appraised at $125,000.

He said, "You are exactly on the money because that financing was worth $20,000 should that purchaser put the house on the market.

And we were just playing with some number. We said: "Let's assume that somebody bought it for $125,000 on the assumption and put $30,000 cash into it. What would the payments be at 9½ percent?" Or let me say they paid $105,000 which is what it is really worth, but $30,000 in the 13½ percent, what the interest rate was at that time.

I think buying if for $20,000 less the payments came out to $250 more than they would have been paying at the higher price.

So in our instance, where there are good assumptions, it has really inflated the price of houses.

Senator **Sarbanes**. Mr. Waggoner.

Mr. **Waggoner**. We have a subdivision, Queensland, listed in our market area along route 301 in Prince Georges County. It is probably one of the lowest priced planned communities in Prince Georges County for single family homes. They started originally in January at $49,900.

Now, a two-bedroom home is selling for $51,900, a low price. That is partially explained by the long commute to the city. It is a low price for a single family home in Prince Georges County. For families that have purchased there, the deliveries are only now taking place.

We have families who purchased there in, say, January or February of 1981, and were the first to take deliveries. Now, when they first purchased, the VA/FHA rate was much, much lower than it is today. Today, the VA/FHA rate is 16½ percent VA, 16½ percent plus a half percent for FHA.

The tragedy right now for the families in this entire group is that most of these people, can't afford that house today. They could in February; they can't in September.

To give you an example of how difficult this situation is, the people that are buying the $50,000 property VA, no money down, have monthly payments of $950 a month to $1,000 a month. It is an outrageous amount of money.

I don't know how you can equate it to anything we are seeing in real estate at any point in time in the past. Years ago in real estate as long as a person put the property on the market and kept in mind a competitive price, financing that is competitive, adequate time to market the property, and corporate selling, we could sell the property. We really could. We could do marketing and help the people.

Today, the emotionalism is out of the window in real estate. As Leo Farrall mentioned, it could be the most beautiful home on the block; but should it not have a suitable loan, it probably wouldn't sell today. It is something that we are witnessing more and more.

On VA and FHA loans, the costs that the seller incurs cannot be passed onto the purchaser. For instance, the purchaser will have to pay one point, the seller pays what the market rate is. Recently, that has been as high as 10 points on the price of a loan the purchaser is receiving.

We are seeing disastrous effects on the economy of the seller. You really can't pass those costs on on a VA or FHA transaction.

Thank you.

Senator SARBANES. Following up on that, what is the situation of the families that have to move because either their company or—in Prince Georges, of course, you have military people as well. They are ordered to transfer. What is occurring in those instances?

Mr. CARDACI. Our most recent transaction involved a company move.

Senator SARBANES. Did they have a benefit program where the company assisted the people, or something?

Mr. CARDACI. Yes. It was a house that required new financing. Fortunately for the seller of that particular home, the person being transferred, his company picked up all the transfer costs, brought the loan down 3 percent for 3 years, which made it affordable for him.

But that is probably maybe 25 percent of the work force. There are people with jobs that have been done away with, and they had to move or military transfers, whenever the costs are picked up, and those people don't have that good fortune that some of the large corporations do where the company buys them.

So I would say 75 to 80 percent of the public that possibility doesn't help.

Mr. FARRALL. In the area in southern Maryland, we have some houses sitting where the people could not sell them and have had to rent them and go to wherever they were being transferred if there was not a third party involved as far as transfer company.

I think the other thing we have to remember is where there is an interest rate situation, a family that would like to move up where someone would come in, a couple years ago, and say, "I would like to move from a $60,000 or $70,000 house to a $100,000 house," and we had interest rates of 12 and 13 percent, they had an income that did qualify for sale of a $100,000 mortgage.

Today because of the interest rates going up, they can't move up because they are not going to get any more price for their dollar. So they are staying where they are.

Senator SARBANES. Gentlemen, we thank you very much.

Could we have the homebuilders' panel, now, please.

We are pleased to have you here. I know it has been a long wait.

I assume you have probably worked out some order among yourselves, so why don't you go ahead and proceed. Please identify yourselves for the reporter.

STATEMENT OF MARTIN PORETSKY, PRESIDENT, METROPOLITAN WASHINGTON BUILDERS ASSOCIATION, PRESIDENT, PORETSKY & STARR, INC., BETHESDA, MD., AND MARYLAND STATE REPRESENTATIVE TO THE NATIONAL ASSOCIATION OF HOME BUILDERS

Mr. PORETSKY. Thank you, sir.

I am Martin Poretsky. I am the actual representative of the State of Maryland to the National Association of Homebuilders. I am also currently president of the Metropolitan Washington Builders Association which is a regional council composed of associations in northern Virginia, Maryland, and the District of Columbia. I am also president of Poretsky and Starr, Inc., a building firm which does activity and possibly occasional construction in Maryland and D.C.

I want to just open with a very few introductory general remarks and turn it over to my colleagues who will be specific.

Senator SARBANES. All right.

Mr. PORETSKY. We certainly thank you for your understanding and past support that you have given our industry. I spoke to you earlier this spring at a breakfast. I don't know; I may or may not have said at that time, but I had the underlying feeling that the real philosophy was that the homebuilding industry certainly looked good for Maryland and for the country.

I don't know if I said that or not. I still feel that way very strongly.

I think a broader view is considerably needed. I am not against bigness or smallness, but just an atmosphere in which both can on their own make their own decisions and survive. The high interest rates syndrome that we have is making that quite difficult.

Otherwise viable businesses are being choked off. As one of the past speakers who is now with the Maryland Realty Co. shows, they are getting more and more jobless because of this.

I implore you and appreciate the help you have given us on the All-Savers Certificate. I shudder to think what might happen in the next 12 months to the savings and loan industry if that does not meet with any additional help. I am not advocating Federal necessity, but I am not sure what will happen to the overall national climate in the next 12 months.

More specifically, too, but again a general feeling, the country needs to have a greater opportunity to incentive for savings rather than incentive for borrowing.

Bob Mitchell who is the president for Mallensocks spoke for me on Wednesday. I just wanted to underscore his remarks from Rockville.

Here in Prince Georges County, new home sales are down under 70 percent where they were as of July 1980.

Senator SARBANES. 70 percent?

Mr. PORETSKY. Yes, sir, the reports we checked on yesterday said new home sales are down 70 percent—69 percent to be exact—from last July of 1980. This is very troublesome because 1980 is not a good year either. There were 1,700 homes built, and they were started in Prince Georges County in 1980. And that was down from 2,500 in 1979.

Another trend that has developed is the kick-out rate house that is sold, but does not get to settlement has tripled that rate of what it was in 1980. One in six contracts that are entered into in new homes today may not make it to settlement.

In other words, the high interest rate, the builders play the average in prime plus 2 percent. That means just that much greater inventory that is involuntarily growing in the housing industry. You work that much harder to sign.

The difference that we have felt in this particular cycle, building admittedly has been a cycle industry, but the cycles have generally lasted over 6 years, the peak and valley occurring within that period of time. There seems to be no light at the end of this tunnel.

1979 was a down turn. We thought 1980 would be better. 1980 has come and gone, and 1981 is no better. We don't know where 1982 will bring us. That, to me, is the current change or difference between this as an aberration of the cycle philosophy.

I want to introduce Charles Ellison, immediately to my left. He is president of the Southern Maryland Chapter of the Homeowners Association, representing St. Mary's, Charles and Calvert Counties. He will speak now and be followed by Homer W. Smith, the president of H. W. Smith Co.

Mike Rose who will speak last, on my right, will be making some what we feel are rather specific recommendations of what might be done specifically in reference to pension funds.

We can only underscore and hope that if you agree with this concept, what we most need is your personal assistance to help commit this program in Maryland. If there is personal money available for it or State's pension funds, different employees' funds, whatever, it would be ideal. Perhaps we can start and lead the way through use of some of those vehicles.

Thank you very much.

Senator **SARBANES**. Thank you.

Mr. Ellison.

STATEMENT OF CHARLES E. ELLISON, JR., VICE PRESIDENT, D. H. STEFFENS CO. AND PRESIDENT, SOUTHERN MARYLAND CHAPTER, SUBURBAN MARYLAND HOME BUILDERS ASSOCIATION, LA PLATA, MD.

Mr. **ELLISON**. Good morning, Senator.

The southern Maryland chapter of the Suburban Maryland Home Builders Association represents builders, subcontractors, professionals, and suppliers involved in the building industry in Charles, St. Mary's and Calvert Counties, Md. That area, as we are well aware, is truly southern Maryland.

On behalf of the chapter, I would like to thank you for the opportunity to speak today. We do appreciate your concern with matters that are of vital interest to this area.

While some of the members of the industry in southern Maryland are large firms, most are small businesses, employing from five to 50 people and having an annual trade from $100,000 to $5 million.

In my positions as president of the southern Maryland chapter and vice president of the D. H. Steffens Co., an engineering/surveying firm that depends on the building industry for 75 percent of its income, I have many opportunities to discuss the problems of the building industry. These discussions involve members of the industry, private citizens, and public officials with no topic being left uncovered.

With respect to the specific concern of this hearing, high interest rates, I can safely state that the high cost of construction loans, the lack of mortgage money, and the inability of borrowers to qualify for what mortgage money is available has stopped southern Maryland's building industry dead in its tracks.

More specifically, the following has occurred:

One, volume at all building-related businesses is down and with no immediate relief in sight: (a) Capital purchases have been delayed; (b) Positions vacated by attrition are not being filled; and (c) Layoffs of employees are taking place or are being anticipated in the very near future.

Two, propective purchasers are unable to buy houses.

Three, the construction of rental housing has stopped.

Four, businesses are being forced to the lending institutions to obtain money for day-to-day operation.

Five, persons wishing to sell their homes and move up or out are unable to find buyers and have to make alternative arrangements.

Six, the general character of the housing market is changing from the construction of single-family detached residences to more dense, townhouses and similar style projects.

While these effects of high interest rates are simply stated, the impact in an area such as southern Maryland is enormous. Fully 35 percent of our incountry work force is employed in the building industry, and the dramatic cuts in that that are occurring will eliminate many positions. Replacement jobs are simply not available at present. And these people will be forced to draw on the public for subsistence.

In addition to the decrease in employment opportunities, it must be recognized that the housing market in southern Maryland appeals to many young, first-time homebuyers. If these new families cannot find or afford to buy housing in southern Maryland, they are eliminated from the housing in Metropolitan Washington or Metropolitian Baltimore areas and must remain at home or in rental units.

In a society that has made home ownership an integral part of its lifestyle, this is a tragic reversal of the American dream.

Admittedly, we do not have the expertise to solve all of this Nation's problems. We do, however, feel that it is both proper and appropriate to give you the benefit of our opinions on the best course of action. They are:

One, the President's program of budget and tax cuts must remain and must be wholeheartedly supported. To the members of our association, this appears to be the first new program and new approach to our economic problems in some time, and it is long overdue.

Two, Congress must scrutinize carefully and possibly delay increase in defense spending. This country is probably not as weak as many think, and it will be better served by a well-thought, carefully managed program than by a hasty, expensive one.

The greatest lesson learned from past social programs is that one can't solve a problem by throwing money at it. It takes thought, imagination, and dedication to find the best solution.

Three, some type of limits must be placed on various investment options. Commonsense tells one that a savings and loan cannot compete with a money market fund if both don't play by similar rules.

Four, the ability of large corporations to tie up money must be reviewed. As a businessman, I find it difficult to accept Du Pont, Seagrams, and Mobil to tie up billions of dollars for the purchase of stock when 90 percent of the people wanting to buy homes cannot find or qualify for mortgages.

Five, new sources of mortgage money, especially reasonably priced mortgage money, must be found. Programs such as the All-Savers Certificate must be supported and implemented if the supply of funds is to be increased.

Six, regulations affecting the building industry, especially at the State and local level, must be kept at the absolute minimum level needed to protect the public. No one benefits from needless paperwork, and the cost is always borne by the consumer.

In conclusion, I would like to state that the building industry of southern Maryland is ready to do its part in solving the problems the country faces. We recognize that we must share the burdens and pay part of the costs.

We do, however, feel that we are entitled to a fighting chance—and in this case fighting change for reasonable interest rates—to keep our employees working, to build our product, and to provide the American public with one of life's essentials—shelter.

Thank you.

Senator SARBANES. Thank you, Mr. Ellison.

Mr. Smith.

STATEMENT OF HOMER W. SMITH, JR., PRESIDENT, H. W. SMITH CO., AND VICE PRESIDENT, SOUTHERN MARYLAND HOME BUILDERS ASSOCIATION, WALDORF, MD.

Mr. SMITH. Good morning, Senator.

My name is Homer Smith. I am vice president of the Southern Maryland Home Builders Association. When I first saw that you were having this hearing, I thought I would come here and scream help and sit down. But I think that is what you are doing, looking for help. I know you have this problem.

And from all the testimony you have heard, I know there is a problem here. You are looking for help. And there are some things we are trying to tell you about, Senator.

I want to thank you for the opportunity to testify before this hearing of the Subcommittee on Investments, Jobs, and Prices. The high rate of interest is the No. 1 problem facing the building industry.

I am a general contractor building mainly commercial jobs. As president of the H. W. Smith Co., located in Waldorf, Md., I have firsthand knowledge of this problem. We simply cannot wait any longer to begin getting the interest rates back to a reasonable level.

At the present time, I have seven projects on my board that would be built at once if the money was available at interest rates of 15 percent or lower. A year ago, 15 percent would have sounded like an awfully high interest rate. Today, it sounds like a low interest rate.

These projects would total approximately 150,000 square feet and create new jobs for approximately 200 employees.

The interest rate must come down and come down now. The only reason there has not been more of an outcry over high interest rates in the past is that President Reagan keeps assuring us that approval of his economic program would quickly bring down interest rates.

As recent as the Ottawa summit, President Reagan assured us and heads of state that high U.S. interest rates were only temporary. The statement of Chairman Volcker has persuaded me that there is no chance of convincing the Federal Reserve Board to be reasonable on the question of interest rates.

I believe we must make this perfectly clear to the Federal Reserve Board. Therefore, we are left with only one choice: To direct President Reagan to press the Federal Reserve Board with the aim of revising current monetary policies. We need to stop using the monetary policy as the only tool to fight inflation.

Chuck Ellison, president of the southern Maryland chapter of the Suburban Maryland Home Builders Association, has outlined six courses of action to be taken, and Martin Poretsky, president of the Metropolitan Washington Builders Association, talked about what the Federal, State, and local governments can do to solve this problem. I wholeheartedly agree with them.

Thank you.

Senator SARBANES. Thank you.

Mr. Rose.

STATEMENT OF MICHAEL T. ROSE, PRESIDENT, MICHAEL T. ROSE ASSOCIATES, INC., SEABROOK, MD.

Mr. ROSE. Senator, my name is Michael T. Rose. I am a residential developer and homebuilder in Prince Georges County.

I would like to thank you and the other members of your committee for this opportunity to report to you on the plight of homebuilders and home buyers here in Prince Georges County, throughout Maryland, and around the Nation. You have traveled throughout this State in the last few days and doubtlessly gathered lots of facts and figures on what today's stunningly high interest rates are doing to people, business, and society.

As a builder, I have an obligation to my employees, my customers, my family, my potential customers, and the local economy.

Unfortunately, over the last few months, I sense that I have let these people down. Because the rug has been pulled out from under the builders. Because there is no mortgage money available for home buyers at rates anywhere near what people are able to qualify for. And the condition I describe includes mortgage rates available to consumers on FHA/VA programs insured and guaranteed by the Federal Government.

As a result, sales and construction have not slowed down. They have stopped entirely. The 1981 market is over. The new-home construction business is at a total, dead-in-the-water standstill.

I've been in this business of providing homes for people 18 years, and my professional appraisal of the bottom line is: It is gone. We now in this county, State, and Nation have an absolute condition of no more construction and no more home starts.

People still visit model homes again and again, hoping we have located some financing they can afford. The demand for new homes is out there; the money isn't. I'm here before you today representing all the homebuilders in this county and in this district of the State, not just big companies, but also little companies, custom builders, contractors, independents, and new-home materials suppliers.

My company built, sold, and delivered more than 100 homes last year in Prince Georges County which was the largest volume in this area. We are proud of the fact and also that our communities and our product have consistently been award winning in terms of design, affordability, and family living.

We are winners, and we are suffering. I know owners of other Metropolitan Washington housing organizations who are in the same boat. The fact that you can be competitive and innovative in business today is tragically eroded by the money market conditions of 16, 17, 18.5 percent mortgage rates and a prime lending rate of over 20 percent.

The only houses being built are those homes where lenders have foreclosed on the builders or allowed them 13, 14, or 15 percent loans to buyers to avoid foreclosure; in which cases, the lenders are charging those builders upward of 10 to 15 points, contending such usury is a bargain.

It is the age-old rule of supply and demand. Today's demand for housing is tremendous, but there is no supply due to the interest rates. The supply in effect has been cut off. Before long, the United States will have a condition similar to so many other countries, where only the very rich can afford to buy a new home. Middle-class people can't even buy now.

Here are some economic facts I compiled yesterday with the help of local lenders such as lawyers, title companies, and mortgage market representatives.

On Tuesday, September 1, 1981, the Federal National Mortgage Association or Fannie Mae, this country's primary purchaser of residential mortgage loans, announced the results of its biweekly auction of conventional loan commitments. The average interest rate was 18.654 percent.

As a result, interest rates nationally for the 2-week period beginning September 1, 1981, and ending September 14, 1981, for 30-year, fixed-rate conventional loans will be approximately 18⅝ percent.

The facts admittedly dramatize the current situation, but are nonetheless valid. Here is the bad news. Did you know the comptroller of the State of Maryland, Louie Goldstein, makes $50,000 a year, as does the State's attorney general? On that salary, the maximum allowable mortgage payments are $1,166 a month. That allows him to get a $62,000 loan based on an 18.5-percent Fannie Mae mortgage.

If we brought it down three full percentage points to a 15.58-percent loan, which would cost me 10 points or $7,350, the maximum loan Louie could qualify for would then be $73,500. And on a $90,000 townhome, that means $17,000 downpayment. All this is assuming the comptroller has no other debts such as car payments, tuition loans, Master Charge, or Visa.

The good news is on the positive side, a U.S. Senator, a Member of the House of Representatives, Governor of the State of Maryland, or the Prince George County executive, who all make approximately $60,000 a year, will qualify for our $90,000 townhouse only, Senator, if they put down in excess of the normal $9,000.

So you see, the Senator, the Congressman, Governor, or county executive will qualify; the comptroller or attorney general won't make it. If you are making $60,667.50 a year, you would qualify, but only in the event you put greater than the normal 10 percent down, because you only qualify for a $78,000 loan. So your downpayment also would be $12,000 as opposed to $9,000. That is, as long as the Senator does not have, again, a car payment, tuition loan, Master Charge, or Visa, which again would reduce your loan.

Even before things stopped entirely last month, the change in our buyer profiles was astounding. Our buyers for months have been single individuals, divorced people, and people living together for the financial benefits.

The cost of mortgage money, which has affected the cost of houses, is undermining the normal, traditional mores in American culture. Family formations are at an all-time low and so is the birth rate. Of our last 144 home sales, only 22 children were accounted for.

I'm sure, Senator and committee members, that in your travels this week, you have heard the National Association of Home Builders' famous plea, "where will our children live." I contend that slogan could be changed right now to "where will we live."

The solution: The shelter security program.

It is not like me or others in my industry to simply wring our hands and ask for help, having given no suggested solutions. The homebuilding industry has always provided better products for better living with changing times. Therefore, I come today with a proposal, some ideas, and details of my own.

We all recognize that high interest rates and the feared crash of the social security program's viability are today's key economic issues. Even ahead of inflation, the social security system will probably be saved somehow. But it will never be able to offer the financial aid and support to retirees, widows, and our elders it was envisioned to do.

Therefore, I propose, Senator, that you consider what I call the shelter security program, a system designed to help finance housing for the young and active while at the same time providing a supplementary, secure, calculable retirement income for those same people when they retire.

My shelter security program system suggests that the Congress, under direction from this subcommittee, explore a progam which would allow large corporate, large union, small business, and individual professional and personal pension plans to invest in the home mortgage market.

Wall Street investment firms for months have been brainstorming new ways to attract pension fund assets of about $650 billion today, soon to reach that $3 trillion mark, into real estate investment.

Until recently, however, virtually all of this effort has been directed only at large pension and retirement plans, the multibillion-dollar public retirement funds, and the mammoth corporate or union plans.

"As far as real estate investment is concerned," says Larry Winston, a senior vice president at E. F. Hutton, "the small plans were totally ignored." By "small plans," he is referring to anything from pension or profit-sharing plans with a few hundred thousand dollars in assets to individual retirement accounts and Keogh plans.

An individual can put away $1,500 a year toward retirement by setting up an IRA plan. Self-employed persons can set up a Keogh plan and stash away up to $7,500 a year.

The small pension plans are no longer ignored. Wall Street giants, E. F. Hutton and Merril Lynch, have each developed programs to bring money from these funds into the real estate market. The result: an almost untapped source of equity could be opened up.

Small plans have been given short shrift when it came to real estate because they couldn't come up with the cash that some investment programs open to pension funds require. Minimum investments of $250,000 or upward of $1 million are not uncommon in the real estate investment funds run by insurance companies and Wall Street firms.

And even if a small plan could scrape together the minimum contribution to get into a real estate investment, there could be problems. The Employee Retirement Income Security Act (ERISA), which regulates most pension plans, requires that a pension plan's assets be sufficiently diversified, a requirement that is hard to meet if the plan's entire assets are sunk into one real estate investment program.

My concept calls for establishment of a reasonable tax-free income on real estate mortgages to investors using pension-fund money tc purchase them. The plan calls for the pension-fund interest on mortgages to be tax-free when it is earned and also when it is received by the individual. This plan would not extend to commercial or retail real estate; it is strictly for residential shelter mortgages.

All pension funds, whether they are large or small, are allowed to generate profits. And those profits are not taxable until the individual takes the money out. I propose if the individual invests in America's residential housing in helping to provide shelter for themselves and other Americans when they go to take out their retirement income, that this retirement income will come back to them in the form of tax-free as well and that the pension plans be required over a specified period of time to invest upward of 50 percent of their assets in real estate mortgages which in turn would provide shelter for the people who are investing it in themselves.

There are really two new ideas in my shelter security program:

One, that it is mandatory for the pension funds to invest upward of 50 percent; and

Two, that the interest income come back to the individual tax free.

Administration of the program could be through the traditional Fanny Mae, Freddie Mae, Ginnie Mae, mortgage market apparatus and subject to all other rules and regulations in place today regarding pension plans.

There are also safeguards in the program because retirement right now is regulated. It is not as if a wealthy person could run out and put $1 million in this program. They can only put into the new plan what the IRA, Keogh, corporate plans, and so forth, allow, which is a good solid return on their investment.

If they invested in stocks or real estate on their own, it would not come back to them tax free. The money for mortgages would be issued by the savings and loans, and we could use existing Fanny Mae, Freddie Mae, Ginnie Mae pools which allow offerings in all increments and all denominations with the mandatory requirement that the pension funds have these loans as part of their portfolio.

Also, under this plan, the lenders involved would know that they are not borrowing short and lending long. Instead, they would be borrowing long and lending long.

Little change in legislation would be required to implement the shelter security program. There are already in place programs that say how much you can set aside for retirement. All this new program does is insure that interest invested in home mortgages comes back to individuals tax free upon retirement in order to supplement social security benefits.

In the meanwhile, the $650 billion in pension funds will make more mortgages available at rates people can afford.

I urge this subcommittee to begin to explore how a shelter security program should be structured and regulated. I pledge my support and that of my colleagues in housing. We must work together to lower interest rates, even if the work takes months, which let's pray it does not.

Thank you.

[The press release referred to by Mr. Rose follows:]

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INTEREST RATES AND HOUSING:
CAN ELECTED OFFICIALS QUALIFY TO BUY?

On Tuesday, September 1, 1981, the Federal National Mortgage Association (FNMA or "Fannie Mae"), this country's primary purchaser of residential mortgage loans, announced the results of its bi-weekly auction of conventional loan commitments. The average interest rate was 18.654%. As a result, interest rates nationally for the two-week period beginning September 1, 1981 and ending September 14, 1981, for 30-year fixed-rate conventional loans will be approximately 18 5/8%.

Curious as to how this rate would affect the ability of an American family to buy a home, and at the request of Michael T. Rose Associates, a prominent area builder, we at Guaranty Mortgage decided to investigate. Specific case studies seemed to offer a way to compare 18 5/8% interest with a 12% interest rate to see how much difference there would be in the size loan and corresponding sale price for which a family could qualify.

For most people, a typical first home in Prince George's County, Maryland, would be a townhouse priced in the 80's or 90's. One such subdivision is Michael T. Rose Associates' "Carriage Walk" in Lanham. There, taxes average $150 per month, Association fees are $29 per month and hazard insurance is $20 per month. We used standard conventional underwriting criteria which require that the maximum housing payment not exceed 28% of gross monthly income. Note, please, that extenuating circumstances such as substantial indebtedness will affect ability to qualify, and that when using VA or FHA underwriting standards instead of conventional ones the results will usually be different. As a reasonable measure, however, of the effect of high rates on today's homebuyer, conventional criteria are both realistic and accurate.

At the upper ranges of most Socio-Economic-Status scales are elected office-holders whose salaries are public knowledge. Below, we show results of our analysis for a United States Senator, for the Attorney General and Comptroller of the State of Maryland, and for the Chairman of the County Council of Prince George's County, Maryland. Since most first-time homebuyers make down-payments of 5-10% of the purchase price, the size loan for which a family qualifies will largely determine the price range in which they can buy.

	United States Senator	Md. Atty. General and Comptroller	Chairman - P.G. County Council
Annual Salary	$60,667.50	$50,000.00	$28,534.00
Maximum Monthly Housing Payment	$ 1,415.00	$ 1,166.67	$ 665.79
MAXIMUM LOAN AMOUNT AT 18 5/8% INTEREST	$78,000.00	$62,000.00	$30,000.00
Required Down Payment To Buy $95,000 Townhouse	$17,000.00 (18%)	$33,000.00 (35%)	$65,000.00 (68%)
MAXIMUM LOAN AMOUNT AT 12% INTEREST	$118,000.00	$94,000.00	$45,000.00

At 18 5/8% interest, with only 5% to 10% cash available for a down payment, neither the U.S. Senator nor the Maryland Attorney General and Comptroller, nor the Chairman of the Prince George's County Council would be able to buy a townhouse in Prince George's County. This would also be true for the Govenor of Maryland ($60,000 income P.A.), Members of the U.S. House of Representatives ($60,667.50 P.A.) and the Prince George's County Executive ($60,816.00 P.A.). The U.S. Secretary of State and other Members of the President's Cabinet ($69,630.00 P.A.) qualify for loans of $91,000 which would just allow them to buy $95,000 townhouses with 5% down.

From a different perspective, in order to buy that $95,000 townhouse with a 10% downpayment and a loan of $85,500, a family would have to earn $65,618 per year to qualify at 18 5/8%. If the interest rate was 12%, minimum family income would be reduced to $46,234. At an interest rate of 12%, the maximum available loan to a prospective buyer is approximately 50% higher than the amount at today's rate. While the numbers of disenfranchised would-be homebuyers are immense even at 12%, we think that the difference between 12% and 18 5/8% speaks for itself. Why, at 12% interest, even Paul Sarbanes, Harry Hughes, and Louis Goldstein would qualify to buy homes of their own in Prince George's County.

Senator **Sarbanes**. Gentlemen, I want to thank all of you for some very thoughtful and helpful statements in this panel. I hope these hearings have helped to establish the premise that current policy ought to shift. Last Sunday I watched Chairman Volcker and the Council of Economic Advisers Chairman Murray Weidenbaum on TV. Mr. Weidenbaum indicated that the Federal Reserve was pursuing a policy which the administration wished them to follow.

And, of course, Chairman Volcker indicated that himself in his own testimony.

It seems to me that is an unacceptable premise. The impact of the policy as it works out at the grassroots level, is not fully appreciated. It is easy enough to sit there and say people have to suffer through it.

But when you come right down to reality, a lot of very able, productive people simply won't be able to suffer through it. They are going to go under. I am not talking about marginal people; they have gone long ago, I gather. Really productive people are now being affected.

Let me ask you this question: As you perceive the situation now, is there a range of interest rates where it would be possible to move from survival activities to reasonable activities without at the same time saying, "Well, the floodgates have simply been opened wide?"

Mr. **Rose**. Senator, the article "Interest Rates and Housing: Can Elected Officials Qualify To Buy?" which I submitted for the record lists your income, the Attorney General's, and the chairman of the Prince Georges County Council, we compare what would happen if the rates dropped from the current 18.65 percent down to 12 percent. And let me read to you the last paragraph [1]:

> From a different perspective, in order to buy that $95,000 townhouse with a 10-percent downpayment and a loan of $85,500, a family would have to earn $65,618 per year to qualify at 18⅝ percent. If the interest rate was 12 percent, minimum family income would be reduced to $46,234. At an interest rate of 12 percent, the maximum available loan to a prospective buyer is approximately 50 percent higher than the amount at today's rate. While the numbers of disenfranchised would-be homebuyers are immense even at 12 percent, we think that the difference between 12 percent and 18⅝ percent speaks for itself. Why, at 12 percent interest, even Paul Sarbanes, Harry Hughes, and Louis Goldstein would qualify to buy homes of their own in Prince Georges County.

Senator **Sarbanes**. I asked earlier——

Mr. **Smith**. Senator, on that same question, in the commercial building business, I mentioned a 15-percent rate. This is a rate that building a project, we could rent the space, stores, office buildings, offer whatever houses, whatever we are building. We could get a payback at this particular time that we could live with.

Mr. **Ellison**. Remember, when you are talking about interest rates, as a homebuilder, you are talking about two phases—one for construction loans associated with a prime rate and one for permanent financing which gives money for purposes.

And I think what Mr. Smith has indicated is the 15- to 16-percent range on the prime rate, 12-percent range of mortgages, we can do something. We can't serve all the people that want to buy homes, but if we can survive as an industry somehow——

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[1] See press release, p. 397.

Senator **Sarbanes**. Earlier, I asked the labor people whether the up-down cycle affect the efficiency of a work force. I wonder whether you have any comment on that.

Mr. **Poretsky**. I wanted to respond to that question you asked this morning because I did disagree with the labor official. I disagree with him for two reasons.

One, that was answered the other day when you asked as far as efficiency of work and stopping or starting or losing people. I had the personal experience in my Virginia jobs in the last recession in the middle of the seventies that most of our crews went back to West Virginia and never came back again.

And then housing increased, and that's where workmanship collapsed.

The other thing, though, the thing that gets to the more philosophical is what you are telling people. You are encouraging people to do a good job, but you were telling them to do a good job with the work hours out of a job. You consider it is over; you have nothing else for them to do.

Mr. **Smith**. I would agree with Mr. Poretsky. We lose a gret capacity when we have to lay fellows off and come back. And we have to keep the continuity going at all times. And we lose some of our key men. And trying to find them to get them back is just a mess.

Senator **Sarbanes**. When you lay them off, the best can usually find something somewhere else that has more stability to it. And they never come back to you; is that true?

Mr. **Poretsky**. In another industry. You are not going to find it in housing, sir.

Senator **Sarbanes**. I mean other industries.

Mr. **Poretsky**. It depends. In the last 2 years, yes, sir, because housing are the only people really affected by the present situation. As it continues now, other industries are becoming affected by the interest rate. And where else can they go now is a very good question.

Mr. **Smith**. I find myself letting the lesser employees go, fellows making the lower rate, and keeping the fellows at the higher rate. And this puts my cost up because I need the fellows at the higher rate. They do a better job and in turn more inflation.

Mr. **Rose**. Sir, we are in the land development business. Three months ago, we were talking to our subcontractors at a meeting and saying, "Already, land developers are shortening up. Everything is going to be stopping." And we are talking to the carpenter and drywall man out there working. Did he feel the effects?

In the last 30 days, our concrete sub had maybe 10 men on the job. Four of them were superintendents from other jobs that he laid off their entire crews. And as our houses are completed, the ones we have under construction, because we are one of the fortunate few that our lenders have decided to provide permanent loans for our customers rather than having us go bankrupt, they have jobs until those houses are finished, but there are no starts.

And with the winter, there will be no new starts, no other jobs for them to go to. There is no residential mortgage money being put forward. There will be a total absolute stop.

The home buyers who are able to buy one of our loans at an attractive rate that our bank has made available, they can turn around and resell those loans as brokers have told you for $10,000 and $20,000 more because we are providing them with suitable loans which is providing for tremendous inflation.

And when our men leave the work force, there is no place for them to come. We have already had meetings to discuss out of the hundreds of people that we employed 2 months ago on how we are going to keep a few, a handful. I could count on one hand the employees next year. And we are going to go fishing. We have no choice.

Senator SARBANES. The other thing, of course, is that your people then will draw unemployment or some support, I gather, from somewhere. Then we will have an increased deficit problem because instead of working and being a wage earner and a taxpayer, they will not be working, and we will be carrying them as a loss. We lose what they were paying in and we also lose what is paid out to them.

Mr. ROSE. When we paid $8,000 in loan funds on a $90,000 townhouse to let you qualify for a house, that means included in that $90,000 price of your house is approximately $15,000 to $20,000 just in pure financing.

Senator SARBANES. We had a fellow yesterday who said that over 50 percent of the cost of a home now is really brick and mortar cost.

Mr. ROSE. That's totally incorrect.

Mr. PORETSKY. Much less.

Mr. ROSE. In 1970, 62 percent. In 1975, the number went below 50 percent. Right now, I would say it is running—Mr. Poretsky can agree or disagree—42 percent. And counting financing, it is about to drop through the 40-percent mark.

Mr. PORETSKY. The thing that is hard to believe, as Mr. Rose said, homebuilding as long as I have been in it, in the last two decades involved in it, is that people have a misconception. If you go to a furniture store and are going to buy a $100 item, the assumption is it has been marked up 50 percent. The housing industry never had that type of spread.

In good years, if we are making 10 percent on a house, that is really doing something. I hesitated to mention it here because I don't have substantiation of it, but I heard somebody mention to me in my office yesterday by coincidence that a study was made nationally over the last year of those firms that made money, those that didn't. What percentage of housing firms are left is beginning to speak for itself.

But the national average from what I understand officially of those that were profitable, their profit margin was 1.8 percent. And it doesn't take very much, then, in point down to make up for carrying costs, high interest rates. That is very little margin cushion in any business.

Senator SARBANES. Gentleman, we thank you very much. It has been a very good series of panels.

The subcommittee is adjourned.

[Whereupon, at 12:45 p.m., the subcommittee adjourned, subject to the call of the Chair.]

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